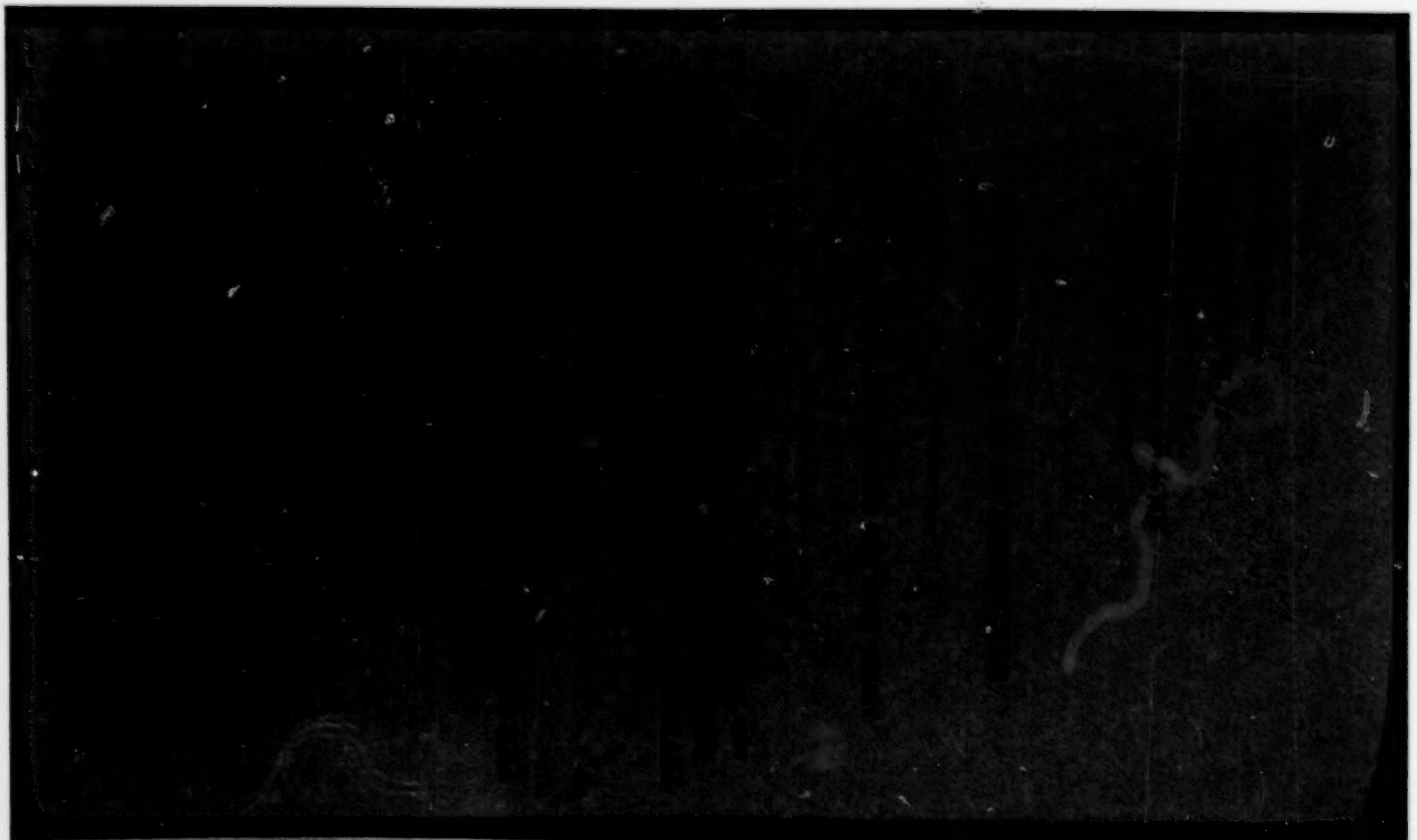


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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 502

THE DELAWARE, LACKAWANNA AND WESTERN RAILROAD COMPANY,

Appellant,

vs.

DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, AND THE STATE OF NEW JERSEY,

---

APPEAL FROM THE SUPREME COURT OF NEW JERSEY

STATEMENT AS TO JURISDICTION

I. Nature of the Case and Statutory Provisions Sustaining Jurisdiction.

This is an appeal under U. S. Code Title 28, Section 1257 (2) (Chapter 646, Public Law 773, 80th Congress, Second Session) from a final judgment of the Supreme Court of New Jersey dated October 17, 1949. The judgment affirmed the assessment of franchise excise taxes against The Delaware, Lackawanna and Western Railroad System for the years 1942, 1943, 1944, 1945 and 1946.

The cases were consolidated by order of the state courts (appellant's appendix, p. 8a).

The appeal questions the constitutionality of the franchise tax provisions of the New Jersey "Railroad Tax Law of 1941" (Chapter 291, P. L. 1941) as amended (Chapter 169, P. L. 1942) as applied by the Director, Division of Taxation, and as construed by the New Jersey courts.

Briefly stated, the "Railroad Tax Law of 1941" lays two taxes upon railroads doing business in the State, (1) an annual property tax upon all property used for railroad purposes (Article II, Secs. 7-12; P. L. 1941, pp. 776, 777), and (2) an annual excise tax upon all railroads operating within the State for the privilege of exercising their respective franchises (Article III of the Statute, Secs. 13-15; P. L. 1941, pp. 777, 778.) Sections 14 and 15 of the Statute and other Sections not presently involved were amended by Chapter 169, P. L. 1942. The Statute provides for a "franchise base" to be computed for each year by deducting $200,000 from the next preceding year's Net Railway Operating Income for each system and railroad not part of a system and allocating such part of the remainder to the State of New Jersey as the number of miles of track over which the railroad or system operates in New Jersey bears to the total number of miles of all track over which it operates. The "franchise base" for each year is the amount so allocated capitalized at 3 per cent. The franchise tax is assessed at the rate of 3 per cent of the excess of the "franchise base" of each system or of each railroad not part of a system over the total taxable valuation of the previous year of all classes of property assessed to and used by the railroad or system for railroad purposes, provided that the minimum tax shall be $4,000 or 30 per cent of the amount of the remainder of its Net Railway Operating Income allocated to the State of New Jersey under Section 14 of the Statute, whichever is greater, but in no event

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shall the franchise tax payable annually exceed an amount equal to 120 per cent of the total property tax levied for such year against the railroad or system.

Section 14 of the Statute defines "Net Railway Operating Income" as follows:

> "Net railway operating income shall be computed as total railway operating revenues from all sources, including any revenue whatever derived directly or indirectly from property which is used for railroad purposes, less costs of railroad maintenance, operation and depreciation, railway tax accruals, uncollectible railway revenues, rentals (both debits and credits) for equipment leased for less than one year or interchanged, and joint facility rents (both debts and credits), and the amount remaining shall constitute the net railway operating income hereinafter mentioned."

This statutory method for calculating Net Railway Operating Income is precisely the same method prescribed by the rules and regulations of the Interstate Commerce Commission for calculating Net Railway Operating Income.

Indeed, the only information received by the State Assessor is from the annual "Form A" report that is required to be filed within three months from the end of the year by each railroad with the Interstate Commerce Commission, a copy of which is immediately filed with the State Tax Department. Appellant is a corporation of the State of Pennsylvania and operates an interstate steam railroad in New Jersey, Pennsylvania and New York. It filed "Form A" reports for the base years 1941 to 1945 inclusive with the Interstate Commerce Commission, and immediately filed two copies thereof with the New Jersey State Tax Department.

The Director, Division of Taxation, for the years 1942 and 1943, originally assessed appellant's franchise excise taxes against the Net Railway Operating Income of ap-

pellant's system as contained in appellant's "Form A" reports. However, in 1944, 1945 and 1946, the Director, Division of Taxation, assessed appellant's franchise excise tax for those years by disallowing accruals which appellant had properly entered in its "Railway Tax Accrual" account, and adding the amount thus disallowed to the Net Railway Operating Income as reported, and arriving at an "adjusted" Net Railway Operating Income much in excess of the true Net Railway Operating Income as reported to the Interstate Commerce Commission, and assessing the tax on the amount of the Net Railway Operating Income as "adjusted."

In 1946 moreover, the Director reassessed the tax for 1942 and 1943 by making disallowances and adjustments similar to those made for 1944, 1945 and 1946, and also reassessed the tax for 1944 and 1945 to reflect the change in the "adjusted" Net Railway Operating Income for 1943 and 1944 resulting from the reassessment of the tax from 1942 and 1943.

The following is a statement of the Net Railway Operating Income of Appellant as reported and as "adjusted" by the Director in his assessments and reassessments for the years 1942 to 1946 inclusive: (Ex D F 2 to D F 6 inc. Ap. pp. 266 to 297a)

1942

ORIGINAL ASSESSMENT

Net Railway Operating Income (as reported to Interstate Commerce Commission, Form A) (year 1941)	$10,125,797.00

REASSESSMENT

Net Railway Operating Income for year ended Dec. 31, 1941 (as reported to Interstate Commerce Commission, Form A)	$10,125,797.00
Add Accrual in 1941 for delinquent taxes—disallowed	800,000.00
Adjusted Net Ry. Oper. Income of System for year ended Dec. 31, 1941	10,925,797.00

1943

ORIGINAL ASSESSMENT

Net Railway Operating Income (as reported to Interstate Commerce Commission, Form A) (year 1942)	$11,648,816.00

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REASSESSMENT

Net Railway Operating Income for year ended Dec. 31, 1942 (as reported to Interstate Commerce Commission, Form A)..	$11,648,816.00
Add Accrual in 1942 for delinquent taxes—disallowed.....	1,200,000.00
Less increase in franchise excise tax levied for year 1942.....	223,359.00
Adjusted Net Ry. Oper. Income of System for year ended Dec. 31, 1942.....	12,625,457.00

1944*

ORIGINAL ASSESSMENT

Net Railway Operating Income for year ended Dec. 31,1943 (as reported to Interstate Commerce Commission, Form A)..	$11,181,280.00
Add Accrual in 1943 for prior year's taxes—disallowed.....	1,200,000.00
Adjusted Net Ry. Oper. Income of System for year ended Dec. 31, 1943.....	12,381,230.00

REASSESSMENT

Net Ry. Oper. Income for year ended Dec. 31, 1943 (as reported to Interstate Commerce Commission, Form A).....	$11,181,280.00
Add Accrual in 1943 for delinquent taxes—disallowed.....	1,200,000.00
Less additional franchise excise tax levied for year 1943.....	273,948.00
Adjusted Net Ry. Oper. Income for year ended Dec. 31, 1943..	12,107,332.00

* This was the first year when the State Tax Commissioner attempted in his original assessment to increase the net railway operating income as reported to the Interstate Commerce Commission.

1945

ORIGINAL ASSESSMENT

Net Railway Operating Income (as reported to Interstate Commerce Commission, Form A) (year 1944).....		$ 6,420,112.00
Add Following Items Disallowed:		
(a) Accrual for Principal of delinquent taxes, years 1934–40.....	$1,230,278.73	
(b) Accrual for Interest on delinquent taxes, years 1934–1940.....	4,932,625.83	
(c) Accrual for Interest on additional assessment for year 1939.....	24,400.00	
Total disallowed.....		$ 6,187,305.00
Adjusted Net Ry. Oper. Income for year ended Dec. 31, 1944..		$12,607,417.00

REASSESSMENT

Net Ry. Oper. Income for year ended Dec. 31, 1944 (as reported to Interstate Commerce Commission, Form A).....		$ 6,420,112.00
Add Following Items Disallowed:		
(a) Accrual for Principal of delinquent taxes, years 1934–1940.....	$1,230,278.73	
(b) Accrual for interest on delinquent taxes, years 1934–1940.....	4,932,625.83	
(c) Accrual for interest on additional assmt. for year 1939.....	24,400.00	
		$ 6,187,305.00
Add Decrease in franchise tax levied for year 1944.....		76,126.00
Adjusted Net Ry. Oper. Income for year ended Dec. 31, 1944..		$12,683,543.00

1946

ASSESSMENT

Net Railway Operating Income for year ended Dec. 31, 1945 (as reported to Interstate Commerce Commission, Form A)..	$ 2,347,900.00
Add Accruals for Interest on delinquent taxes.....	2,845,163.00
Add Accruals for 1941 Reassessment.....	530,902.00
Less Additional franchise tax assessed in 1945.....	21,086.00
Adjusted Net Ry. Oper. Income of System for year ended Dec. 31, 1945.....	$ 5,702,879.00

The following table shows that the franchise excise taxes for the years in controversy against appellant, if assessed on the Net Railway Operating Income as reported and allowed by the Interstate Commerce Commission, would aggregate $4,097,001.60; that as assessed for 1946 and as reassessed for the earlier years they aggregate $6,211,983.45. The increases made in appellant's franchise taxes by the arbitrary action of the Director, Division of Taxation, aggregate $2,114,981.85.

Year	Franchise Tax Based on Net Railway Operating Income as Reported to the I.C.C.	Franchise Tax as Assessed and Reassessed by the Director	Increase in Franchise Tax
1942	$ 882,362.37	$1,105,721.37	$ 223,359.00
1943	1,338,820.32	1,612,768.32	273,948.00
1944	1,182,665.31	1,440,001.29	257,335.98
1945	516,857.70	1,601,825.97	1,084,968.27
1946	176,295.90	451,666.50	275,370.60
Total	$4,097,001.60	$6,211,983.45	$2,114,981.85

Appellant appealed from each of the assessments to the Division of Tax Appeals as permitted by Sections 31 and 32 of the Railroad Tax Law of 1941 (Chapter 291, P. L. 1941, p. 784) and in each of his Complaints and Appeals made the following allegations:

> "4. Chapter 291 of the Laws of 1941 as amended, under which said tax was attempted to be reassessed and levied, is, as construed and applied by the Director, Division of Taxation, unconstitutional and null and void for the following reasons:
>
> "(A) It unduly burdens the interstate commerce in which the Delaware, Lackawanna and Western

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Railroad System was and is engaged, in violation of Art. I, Sec. 8, Par. 3 of the Constitution of the United States.

. . • • • • • • •

"(C) It deprives the Delaware, Lackawanna and Western Railroad System of its property without due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States."

(Ap. pp. 17a, 24a, 31a, 40a and 48a.)

Also:

"3. Your petitioner alleges that said reassessment as made is illegal and null and void for the following reasons:

• • • • • • • •

"(B) The action of the Director, Division of Taxation in determining the adjusted net railway operating income of the Delaware, Lackawanna and Western Railroad System for the year ended December 31, 1941 to be $10,925,797.00 was arbitrary, capricious and confiscatory, and was beyond the lawful power and authority of the said Director.

"(C) The action of the said Director, Division of Taxation, in attempting to adjust the system net railway operating income of the Delaware, Lackawanna and Western Railroad System for the year ended December 31, 1941 by increasing the same from $10,125,797.00, as reported to and determined by the Interstate Commerce Commission four years previously pursuant to the provisions of the Interstate Commerce Act, and on the basis of accounting methods prescribed and approved by the Interstate Commerce Commission, whereby a franchise excise tax was reassessed against the said System in the amount of $1,105,721.37, operates as and is in fact an undue burden on the interstate commerce in which the Delaware, Lackawanna and Western Rail-

road System is and was engaged, all in violation of Art. 1, Sec. 8, Par. 3 of the Constitution of the United States."

(Ap. pp. 16a and 17a (1942 Appeal).)

Like allegations were made in the Complaints and Appeals from the assessments for the years 1943 to 1946, inclusive, the figures however being necessarily different for each year (Ap. pp. 23a, 30a, 37a and 46a). The cases were heard together by the Division of Tax Appeals, and all were affirmed by judgment of the Division on May 16, 1946 (Ap. pp. 57a-66a, inclusive). The opinion of the Division did not discuss the constitutional question (Ap. p. 51a). On February 19, 1948, the New Jersey Supreme Court (the former court of original jurisdiction) allowed appellant five writs of certiorari to review the judgments of the Division of Tax Appeals aforesaid, and immediately signed an order of consolidation of all the causes into one (Ap. pp. 1a-8a, inclusive). In appellant's Reasons, filed in such former New Jersey Supreme Court on March 18, 1948, for setting aside by that Court on certiorari the judgments of the Division of Tax Appeals aforesaid, appellant alleged the unconstitutionality of the statute as construed and applied and the invalidity of the assessments as unduly burdening the interstate commerce in which appellant was and is engaged, in violation of Article I, Section 8, Paragraph 3 of the Constitution of the United States, and as depriving appellant of its property without due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States (Ap. pp. 9a-11a). The hearing on the writs of certiorari was held before the New Jersey Superior Court, Appellate Division (New Jersey meanwhile having adopted a new constitution which abolished the old Supreme Court and transferred its appellate jurisdiction to the appellate division of the Superior Court). The Appellate Divi-

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sion on March 25, 1949, entered a judgment affirming the judgments of the Division of Tax Appeals (Ap. p. 370a). The opinion of the Court, written by Judge Bigelow, contains no reference to the questions of constitutional law that had been raised and argued. (Ap. pp. 354a to 359a). On May 9, 1949, appellant appealed to the new Supreme Court of New Jersey (the present court of last resort) from the final judgment of the Appellate Division (Ap. p. 353a), no assignments of error being required to be filed. On appeal, appellant argued the constitutional questions as asserted in the Complaints and Appeals to the Division of Tax Appeals, and in the Reasons filed in support of its writs of certiorari. The Supreme Court in its opinion said:

> "Appellants assert the action of the Director of the Division of Tax Appeals was, in effect, an arbitrary increase of the operating income and constituted an assessment not only attributable to New Jersey but actually upon the earnings of the railroad in other states in which the system operates. It is claimed that such action constituted an unreasonable burden upon interstate commerce and operates as a denial of due process. The point is not well taken."

II. State Statute the Validity of Which Is Involved

From the foregoing it is shown that there were drawn in question (1) the constitutionality of Sections 13, 14 and 15 of the Railroad Tax Law of the State of New Jersey of 1941 as amended, as construed and applied by the Director, Division of Taxation, the Division of Tax Appeals, and the courts of New Jersey under the commerce clause and the Fourteenth Amendment of the Federal Constitution, and (2) the constitutional validity of the arbitrary and capricious action of the Director, Division of Taxation in making his assessment by increasing appellant's Net Railway Operating Income in a manner not authorized by statute or

by sound accounting rules but permitted by the New Jersey Courts so as greatly to increase appellant's Net Railway Operating Income for the base years 1941-1945 inclusive, and levying taxes thereon that were $2,114,981.85 greater than they should have been.

The statute under which the franchise excise taxes were assessed is the 1941 Railroad Tax Act (Chap. 291, P. L. 1941, as amended by Chap. 169, P. L. 1942 (R. S. 54:29A-13 *et seq.*)) The pertinent provisions of this statute as amended are as follows:

> "13. Franchise excise. An annual excise tax is hereby levied upon all railroads operating within this State for the privilege of exercising their respective franchises, to be computed in the manner hereinafter provided. This tax shall be in lieu of any other tax or taxes of or upon such franchises."
>
> "14. Franchise base. For the purpose of this section, net railway operating income shall be computed as total railway operating revenues from all sources, including any revenue whatever derived directly or indirectly from property which is used for railroad purposes, less costs of railroad maintenance, operation and depreciation, railway tax accruals, uncollectible railway revenues, rentals (both debits and credits) for equipment leased for less than one year of interchanged, and joint facility rents (both debits and credits), and the amount remaining shall constitute the net railway operating income hereinafter mentioned. Deductions from operating revenues for depreciation, additions and betterments, and compensation for personal services shall be subject to regulation by the commissioner, as to reasonableness of amount and appropriateness of accounting distribution. Depreciation charges shall in no instance, however, exceed the amount claimed by the railroad for depreciation in its report or reports to the Interstate Commerce Commission and fixed, or if none was claimed then as fixed, by the Interstate Commerce Commission in determining the net railway

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operating income of the railroad for the year under consideration.

"A 'franchise base' shall be computed for each year by deducting the sum of two hundred thousand dollars ($200,000.00) from the next preceding year's net railway operating income for each system, and railroad not part of a system, as above defined, and allocating such part of the remainder to the State of New Jersey, as the number of miles of all track over which the railroad or system operates in this State bears to the total number of miles of all track over which it operates. The franchise base for each year shall be the amount so allocated capitalized at three per centum (3%), * * *."

"15. Rate; computation. Subject to the minimum and maximum limits hereinafter stated, the franchise tax shall be assessed at the rate of three per centum (3%) of the excess of the 'franchise base' of each system and of each railroad not part of a system, over the total taxable valuation of the previous year of all classes of property assessed to and used by the railroad or system for railroad purposes, as finally determined pursuant to this act, provided that, except as hereinafter stated, the minimum franchise tax payable annually by such system or railroad not part of a system shall be either the amount of four thousand dollars ($4,000.00), or thirty per centum (30%) of the amount of the remainder of its net railway operating income allocated to the State of New Jersey in the manner provided in section fourteen of the act hereby amended, whichever is greater; but in no event shall the franchise tax payable annually by such system or railroad not part of a system exceed an amount equal to one hundred and twenty per centum (120%) of the total property tax levied for such year against such railroad or system under section seven of this act. * * *"

The Joint Committee of the New Jersey Legislature which drafted the 1941 Railroad Tax Act said in its report to

the Legislature, with reference to the definition of net railway operating income contained in section 14 of the act:

> "Definitions used are those prescribed by the United States Interstate Commerce Commission. Accounting procedures by which the returns are filed are also prescribed and supervised by that Commission" (Ap. p. 331a)

III. Dates of Judgments and Appeals

The final judgment of the Supreme Court of New Jersey, affirming the judgment of the Appellate Division, was rendered on October 17, 1949.

The New Jersey Supreme Court on October 31, 1949, made an order holding its mandate for forty-five days. A petition for appeal to this Court will be presented to the Hon. Arthur T. Vanderbilt, Chief Justice of the Supreme Court of New Jersey on December 12, 1949.

IV. Manner in Which Federal Questions Were Raised

The Federal questions were raised at the outset and argues throughout all the proceedings in the Division of Tax Appeals, an administrative agency, and in the old New Jersey Supreme Court, in the Reasons for granting writs of certiorari, and in the Appellate Division, which after the adoption of the new constitution for New Jersey took over the appellate jurisdiction of the former New Jersey Supreme Court, and in the new Supreme Court of New Jersey. Precisely how the Federal questions were presented is stated *supra,* pages 6 to 9. Before each tribunal and in each court it was alleged that the provisions for assessing and levying a franchise tax in the Railroad Tax Law of 1941, as construed and applied by the Director, Division of Taxation, were null and void because they constituted an unreasonable burden upon the inter-

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state commerce in which appellant was engaged in violation of the commerce clause of the Federal Constitution, and because they deprived appellant of property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States. Likewise before each tribunal and in each court it was alleged that the arbitrary and capricious action of the Director, Division of Taxation in greatly increasing the Net Railway Operating Income of appellant and levying taxes against appellant much greater than the plain language of the tax law specified, operated as an undue burden on the interstate commerce in which appellant is engaged in violation of the commerce clause, and deprived appellant of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

The opinion of the Supreme Court of New Jersey, appended to this statement, affirmatively shows that the Federal questions were presented and heard and decided by it, although the court referred only to the assessment as being valid but did not specifically mention that the statute was valid as against the constitutional objections made by appellant. It follows that the court having held the assessment valid over appellant's objections determined necessarily that the statute as construed also was valid.

V. The Federal Questions Are Substantial

The ultimate Federal questions presented to the Supreme Court of New Jersey were:

A. Whether the franchise tax provisions of the Railroad Tax Law of New Jersey of 1941, as amended, as applied by the Director, Division of Taxation, and construed by the New Jersey courts, operate as an unreasonable burden on the interstate commerce in which appellant is engaged.

B. The validity under the Fourteenth Amendment of the franchise tax provisions of the New Jersey statute as con-

strued by the Director, Division of Taxation, and the New Jersey courts.

C. The constitutional validity of the arbitrary and capricious action of the Director, Division of Taxation, under the commerce clause of the Federal Constitution, and the due process clause of the Fourteenth Amendment, in making assessments of franchise taxes against appellant much greater than the language of the statute permits.

D. Whether the effect of the action complained of is not a tax by the State of New Jersey on gross income of an interstate steam railroad derived from its operations outside of New Jersey.

In sustaining the validity of the franchise tax provisions of the New Jersey statute as well as the arbitrary and capricious action of the Director, Division of Taxation, in assessing franchise excise taxes against appellant for 1942 to 1946 inclusive, the Supreme Court of New Jersey decided important Federal questions in a way which conflicts with applicable decisions of this Court.

The statute undertakes to determine how much of the earnings of an interstate railroad were made in the State of New Jersey by taking the Net Railway Operating Income of the system, where made in three States, and taking as a base for taxation by New Jersey that proportion thereof which the mileage of the railroad in New Jersey bears to the total mileage of the system. This Court has held that such a method of determining the earnings in a given state of an interstate system is not *per se* unreasonable.

Atlantic Coast Line R. Co. v. *Daughton*, 262 U. S. 413 (1923);

Norfolk & W. R. Co. v. *North Carolina*, 297 U. S. 682, 684 (1936);

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See: *Western Live Stock* v. *Bureau of Revenue*, 303 U. S. 250 (Stone J.) (1938).

Instead, however, of strictly applying this statute as it is written, the Director, Division of Taxation with the approval of the courts of New Jersey, has so applied it as to decrease the charges appellant properly made to the system Railway Tax Accruals account and to increase to that extent the system Net Railway Operating Income and then to levy the tax at the rate fixed by the statute on the augmented or "adjusted" system Net Railway Operating Income allocated to New Jersey.

Introductory Explanation of the Items Disallowed by the Director

Except for the addition or deduction of additional franchise taxes resulting from the action of the Director in reassessing the taxes for the above years, all of the errors complained of result from the action of the Director in disallowing deductions that appellant had taken in its annual income reports to the Interstate Commerce Commission for taxes accrued and interest on deliquent taxes.

The taxes, and interest on taxes which the Interstate Commerce Commission permitted to be accrued but the Director disallowed as accruals, with the sole exception of additional 1941 taxes hereafter mentioned, originated in the depression years when railroad revenues declined tremendously because of lack of general business while the tax burden remained constant, and every railroad doing business in the State, except the Pennsylvania, was unable to pay its taxes in full as they were assessed. In these depression years appellant paid approximately 70% of its property taxes (See Ex. DF-7, P. 298a) in each year as they were assessed and accrued the amount so paid but contested the remainder of such taxes, approximately 30%,

on the grounds that the assessed valuations were excessive and that there was discrimination between railroad taxpayers and other taxpayers in the State, in that the railroad properties were assessed at a higher level of value than other property.

After appeals in the State administrative agencies and courts from such valuations were decided against the railroads, actions were commenced in the Federal Court to restrain the collection of more than 70% of the taxes on the ground of unjust discrimination. Judge Forman in the United State District Court granted an injunction restraining the State from collecting more than 70% of the taxes assessed for 1934, 1935 and 1936. *Central R. Co. v. Martin (ten cases)* 30 Fed. Supp. 41. This decision was reversed by the Circuit Court of Appeals (24 cases) 115 Fed. (2d) 968 (November 27, 1940), and this court denied certiorari April 28, 1941, (313 U. S. 568), on which date the liability of appellant to pay the contested 30% of its taxes for 1934-1936 was determined. At that time the 30% of the taxes assessed for the years 1937 to 1940 inclusive was being contested in the appropriate administrative tribunal. (Ap. p. 74a, L. 20).

On July 22, 1941 the new Railroad Tax Settlement Act (Chap. 290, P. L. of New Jersey 1941) became effective, which contained an offer to the railroads, including appellant, to settle all appeals and contests concerning back taxes, the State agreeing to accept the principal of the taxes assessed on the partial payment basis over a period of years with interest at 3% per annum from December 1, 1940 until paid. The old statute required the payment of penalty interest at 12% per annum on delinquent taxes, this penalty interest from the date of assessment to December 1, 1940 was forgiven by the 1941 Tax Settlement Act. The Lackawanna, under the formula of this statute, had ten years within which to pay its back taxes and interest on the un-

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paid principal at 3% per annum from December 1, 1940. The Lackawanna promptly accepted the provisions of this statute, filed its undertaking to pay its taxes in installments over a period of ten years with interest at 3% from December 1, 1940, discontinued all pending contests, and delivered to the State Treasurer certified checks for so much of the taxes as had to be paid immediately. Simultaneously with the passage of the Tax Settlement Act, the State passed the Railroad Tax Law of 1941 (Chap. 291, P. L. 1941) under which the assessments under review in this case were made. After appellant had filed its undertaking under the Settlement Act and had discontinued all contests, and had made the payments above referred, the Attorney General of the State of New Jersey, on September 4, 1941 filed in the Court of Chancery a Civil Information alleging, among other things, that the Settlement Act was unconstitutional as amounting to a donation to the railroads by the State of the interest at 12% per annum on the unpaid part of the taxes. The Legislature amended the Tax Settlement Act (Chap. 291, P.L. 1942) in an attempt to overcome the objections made by the Attorney General in his Civil Information suit.

Explanation of Accruals Disallowed by the Director With Respect to the Base Years 1941-1944, Inclusive

As above stated, appellant had paid and accrued approximately 70% of its New Jersey taxes assessed for the years 1934-1940 inclusive. Ex. DF-7 (Ap. 298a) shows the taxes levied in each year, the taxes paid in each year to the date of the Settlement Act, the balance unpaid at the date of the Settlement Act, and the amount of taxes accrued on the books.

The taxes levied against appellant from 1934 to 1940 inclusive aggregated $22,040,371.50. Appellant had paid to the date of the Settlement Act $14,804,224.21; there was a

balance due and unpaid of $7,236,147.29, and between the years 1934 and 1940 inclusive appellant had accrued on its books $16,045,110.55, leaving $5,995,260.95 that had never been accrued, i.e., charged against appellant's income (Ex. DF-7, Ap. 298a).

When appellant accepted the provisions of the Settlement Act, discontinued all appeals and contests of taxes and executed and filed its written undertaking agreeing to pay the principal of the unpaid taxes with interest at 3% per annum from December 1, 1940, its Comptroller, Mr. Jonas set up as a liability in the year 1941 the balance of taxes unpaid at the date of the Settlement Act, $7,236,147.29 (Ex. DF-7, Ap. 298a) in two balance sheet accounts, No. 767, "Accrued Tax Liability" (in which I.C.C. accounting rules permitted only two years' tax liabilities to be included), and the remainder in No. 770, "Other Deferred Liabilities" (Jonas Ap. 261a, Barnes Ap. 120a).

Mr. Jonas, having accrued this whole liability to the proper balance sheet accounts, Nos. 767 and 770, thereupon commenced, in May, 1941, to charge the unaccrued sum, to wit, $5,995,260.95, against the income account #532, "Railway Tax Accruals", at the rate of $100,000.00 per month.

The record shows that the accounts of appellant have been regularly audited by the accounting firm of Haskins & Sells since 1924. They approved Mr. Jonas' accounting as above recited (Ap. 184a).

Likewise, the accounts of all steam railroads are annually audited by examiners of the Interstate Commerce Commission. The I.C.C. Examiner who audited appellant's 1941 accounts took exception to the fact that on December 1, 1941, after $800,000 of the tax liability had been accrued in Account #532, "Railway Tax Accruals", the unaccrued balance of $5,195,261 was charged to Balance Sheet Account #727, "Other Unadjusted Debits", with concurrent credit to Balance Sheet Account #767, "Accrued Tax Lia-

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bility", and Balance Sheet Account #770, "Other Deferred Liabilities" (Ap. 3032, 24-31). Whereupon Mr. Jonas, as permitted by the I.C.C. Rules and Regulations, submitted the question as to the propriety of his accounting to Mr. Crandall, Director of the Bureau of Accounts of the Interstate Commerce Commission (Ap. 302a). He said in part in that letter:

> "The proposed exception taken by your examiners related to the charge of $5,195,261 to Account 727 'Other Unadjusted Debits', the proposal being to charge said amount either to Account 532 'Railway Tax Accruals' or to Account 557 'Delayed Income Debits'. To make such an unusual charge against either of these accounts in one year would make those accounts disproportionate and would disturb comparisons.
>
> "What we would like to obtain is special permission to continue to accrue these back taxes at the rate of $100,000 per month. At that rate we will have accrued by the end of 1944, an amount of $4,400,000 as follows:
>
> | | |
> |---|---|
> | 1941 . . . . | $ 800,000 |
> | 1942 . . . . | 1,200,000 |
> | 1943 . . . . | 1,200,000 |
> | 1944 . . . . | 1,200,000 |
> | | $4,400,000." (Ap. 303a, 304a) |

On August 11, 1942, Mr. Crandall, Director of the Bureau of Accounts of the I.C.C., wrote Mr. Jonas saying:

> "Your application has been considered and approved by the Commission.
>
> "The accrual of these State of New Jersey taxes at the rate of $100,000 per month up to the end of 1944 will produce a balance in the reserve account of $4,400,000, and that sum plus the amount of $1,564,982 carried in reserve for possible liability for payment for lessors' income taxes, if the latter amount will not be needed for the original purpose for which it was set up, will pro-

duce a total in the reserve account of $5,964,982. It is understood that this latter amount will be sufficient to provide for the entire unaccrued New Jersey taxes by the end of 1944." (Exs. DF-9 & S-8, Ap. 305a)

The significant point here is that there was no exception taken to the charge of $800,000.00 to income account #532, "Railway Tax Accruals" in 1941; the exception was only to the fact that the balance of the tax amounting to $5,195,-261.00 had been temporarily charged to account #727, "Other Unadjusted Debits", which was a balance sheet rather than an income account.

Although the formula in the Settlement Act (Chap. 290, P. L. 1941) permitted appellant to pay these back taxes over a period of ten years, nevertheless they were actually paid by appellant as follows:

1941	Amount Accrued	$ 800,000
	Amount paid	832,000*
1942	Accrued and paid	1,200,000*
1943	Accrued and paid	1,200,000*
1944	Accrued and paid	The balance.

(Jonas, Ap. 176a)

* Certified checks in these amounts were delivered to and held by the state until 1944 when they were cashed. When such checks were certified the amounts thereof were charged against appellant's bank balances, i. e., they were paid so far as appellant was concerned.

Accruals Disallowed by the Director With Respect to the Base Year 1944, due to the Decision in Wilentz v. Hendrickson

In the 1945 re-assessment (based on the 1944 earnings), the Director attempted to increase appellant's Net Railway Operating Income by disallowing as deductions from "Railway Tax Accruals" the following items:

(a) Accruals for Principal of delinquent taxes, years 1934–1940	$1,230,278.73
(b) Accrual for Interest on delinquent taxes, years 1934–1940	4,932,625.83
(c) Accrual for Interest on additional assessment for year 1939	24,400.00
	$6,187,305.00

(Ap. 28a)

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thereby practically doubling the Net Railway Operating Income of the System as reported to the Interstate Commerce Commission.

The first item, above mentioned disallowed as an accrual, $1,230,278.73, was the last of the charges to account #532 "Railway Tax Accruals", of the principal of taxes that appellant agreed to pay in the undertaking that it filed when it accepted the terms of the Settlement Act and which it paid in 1944.

The second item, $4,932,625.83, was the interest that had accrued to the date of payment on the principal of the delinquent taxes for the years 1933 to 1940 inclusive. This was the amount that the settlement act attempted to forgive and that was on June 22, 1944 determined to be payable in *Wilentz* v. *Hendrickson*, 135 N.J. Eq. 244, 256 which held that the Tax Settlement Act (Chap. 290, P. L. 1941), as amended and supplemented by Chap. 241, P. L. 1942, was unconstitutional and that the interest accruing on railroad taxes under R.S. 54:27-4 merges in what the statute itself denominates as "debt" to the State; that it is annexed to the "debt" so as to constitute it an "integrated part of the tax debt." Following the Wilentz decision, the New Jersey Court of Errors and Appeals said in *Jersey City* v. *Zink* (1945), 133 N.J.L. 437:

> "Is the interest on delinquent taxes against Class II railroad properties a part of the tax and does it follow the principal? We conclude that it is and does."

It was as the result of the opinion in *Wilentz* v. *Hendrickson* (supra) that appellant became liable in the year 1944 to pay, and actually paid the very large interest item above mentioned and on the authority of *Wilentz* v. *Hendrickson* charged the amount paid to Railway Tax Accruals. Later this accrual was approved by the Interstate Commerce Com-

mission. Nevertheless it was disallowed by the Direction, Division of Taxation.

The third item, $24,400.00, was interest on $89,960.00 of Jersey City local taxes for the year 1939 that had been appealed. The principal and interest of such taxes was paid in 1944, when the appeal from the assessment was discontinued. Strange to say, the Director allowed appellant to deduct the principal, but denied its right to deduct the interest thereon (Ap. 76a, 77a). See details of charges, Ex. DF-8 (Ap. 299a).

After the decision of *Wilentz* v. *Hendrickson*, and on October 12, 1944, Mr. Jonas wrote to Mr. Crandall, Director of the Bureau of Accounts of the Interstate Commerce Commission, informing him of this decision, calling attention to his letter of August 11, 1942 (supra) (Ex. DF-9, Ap. 305a), and asking whether the interest on the past due taxes should be charged to the account "Railway Tax Accruals" in view of the decision in *Wilentz* v. *Hendrickson* to the effect that in New Jersey the statutory interest "together with principal taxes constituted the tax debt due from each of the private railroad companies to the State" (see Jonas letter, Ex. S-13, Ap. 306a).

On December 18, 1944 Mr. Crandall communicated to Mr. Jonas the decision of the Commission that

> "In view of the decision of the Court that the penalty interest is a component part of the principal tax, such interest is a proper charge to Account 532, 'Railway Tax Accruals'."

Accordingly, Mr. Jonas charged to Account No. 532, "Railway Tax Accruals", in the year 1944, the interest that the Legislature attempted to forgive when it passed the Railroad Tax Settlement Act, Chap. 290, P. L. 1941, amounting to $4,932,625, and which was actually paid in 1944 (Jonas, Ap. 181a, L. 30).

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Deductions Disallowed by the Director With Respect to the Base Year 1945

The items disallowed in the 1946 assessment were the following charges to the account "Railway Tax Accruals" in appellant's 1945 Form A report to the Interstate Commerce Commission:

"4a.	Add Accruals for Interest on Delinquent Taxes.....	$2,845,163
"4b.	Add Accruals for 1941 Reassessment.....	$ 530,902"
		(Ap. 297a)

On June 11, 1945, the N. J. Supreme Court in *State* v. *Erie Railroad Co., et al.*, 23 N. J. Misc. 203, held that where the railroads doing business in the State, including appellant, made partial payments on their delinquent property taxes, the Comptroller must divide such payments into two component parts, so that one of them would represent interest at the statutory rate on the other for the period of the delinquency, and that the interest component would then be deductible from the balance of interest owing at the time of payment and the principal component would be deductible from the balance of principal owing at that time. This case also held that the State Comptroller must reapply the payments theretofore made to both principal and interest in accordance with the opinion, there being no estoppel against the State.

After the decision in *State* v. *Erie Railroad Co.* was filed, the State Comptroller recalculated the amounts due to the State in accordance with that opinion (Ap. 103a), and determined that appellant owed the additional amount of $2,845,163, which appellant paid in the year 1945, the year of the decision. Appellant charged the amount to Account No. 532, "Railway Tax Accruals", in accordance with the ruling of the Interstate Commerce Commission in respect of the interest charge of $4,923,625.83 in 1944 (See Ex. DF-8, Ap. 299a).

The second charge to "Railway Tax Accruals" that was

disallowed by the Director in 1946, $530,902, resulted from the decision of the New Jersey Supreme Court in *Jersey City* v. *State Board of Tax Appeals,* 133 N.J.L. 202, decided August 29, 1945.

The 1941 Tax Law (Chap. 291, P. L. 1941) was approved July 22, 1941. Prior thereto, property taxes for 1941 had been assessed against appellant pursuant to the provisions of Chapter 208, P. L. 1888, as amended and then in full force and effect (R. S. 54:19-1 et seq.). Such taxes were not payable, however, until December 1st in that year.

After the passage of the Railroad Tax Law of 1941 (R. S. 54:29A-1 et seq.), which expressly abated taxes for 1941 assessed under the old law (Sec. 74) the State Tax Commissioner assessed against appellant taxes for the year 1941 under the new law, as required by Sec. 7 thereof, which appellant paid.

The decision of the Supreme Court in *Jersey City* v. *State Board of Tax Appeals* held that with respect to the tax year 1941 the provisions of the Railroad Tax Law of 1941 (Chap. 291, P. L. 1941), as amended by Chap. 169, P. L. 1942, were invalid and in violation of the Constitution. The Rule for Judgment entered October 16, 1945 (Ex. P-5-7, Ap. 345a) adjudged that all of the assessments of property and franchise excise taxes made by the State Tax Commissioner for the year 1941, under the Railroad Tax Law of 1941, were null and void, and that all of the assessments of railroad property made by the Tax Commissioner for 1941, pursuant to the Revised Statutes of 1937, were valid, lawful and subsisting obligations of the taxpayers, subject to credit in favor of such taxpayers against said obligations for any sums paid on account of property or franchise excise tax assessments purportedly made for the year 1941 pursuant to the Railroad Tax Law of 1941. After this opinion of the Supreme Court was filed, appellant wrote to Commissioner Zink enclosing a

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check for the additional amount of principal taxes claimed by the State to be due for the year 1941 under said decision (Ex. S-1, Ap. 348a), of which the State acknowledged receipt on September 14, 1945 (Ex. S-2, Ap. 349a).

This item of $530,902. first became an obligation of appellant in 1945 when it was adjudicated and paid and was properly accrued in that year.

Chestnut Securities Co. v. *United States,* 62 Fed. Supp. 574 (1945).

All of the taxes involved in this appeal have been paid (Ap. 79a, L. 25; Ap. 52a, L.2).

Appellant's accounting was performed not only in accordance with the rules and regulations and express directions of the Interstate Commerce Commission, but it was approved by Haskins & Sells who annually audited appellant's books.

Its books being required to be kept on the accrual system of accounting were kept according to proper rules of accrual accounting.

Dixie Pine Products Co. v. *Commissioner,* 320 U. S. 516;

Security Flour Mills Co. v. *Commissioner,* 321 U. S. 281;

Green Oil Soap Co. v. *Reinecke,* 36 Fed. (2d) 600 (1929);

Block & Kohner Mercantile Co. v. *United States,* 37 Fed. (2d) 877, 879, 880 (1930);

Seabright Woven Felt Co. v. *Ham,* 38 Fed. (2d) 114 (1930);

Chestnut Securities Co. v. *United States,* 62 Fed. Supp. 574, 576 (1945).

See also:

"Theory of Accounts" (revised edition, 1941), p. 320. By Arthur H. Rosenkampff and William Wider, Professors of Accounting, New York University.

The Lehigh Valley Railroad Co., like appellant, was involved in the question of the proper year or years in which to deduct, for Federal Income tax purposes, the principal and interest of the back New Jersey taxes that had been in litigation. The Commissioner of Internal Revenue disallowed such deductions and determined deficiencies in income tax against the Lehigh Valley Railroad Co. and affiliated companies for the years 1941 to 1944 both inclusive. From such deficiencies the Lehigh Valley Railroad Co. appealed to the Tax Court of the United States. The opinion of the Tax Court, held:

> "In our judgment, the unpaid amount of the taxes imposed in each of the years 1932-1940, which was contested in the courts, was so contingent and uncertain as to make accrual improper until the termination or discontinuance of the litigation. We hold, therefore, that the amounts of the 1932-1933 taxes which were unpaid and in litigation on January 1, 1939, accrued in 1939; that the amounts of the 1934-1936, and the 1937-1940 taxes which were unpaid and in litigation on January 1, 1941, accrued in 1941."

The case is reported in 12 T. C. (No. 130) 977; C. C. H. Tax Ct. Rep. Dec. 17,027 at page 3043; 1949 P. H. T. C. Par. 12.130.

Annexed hereto is a statement made by appellant from its Form A. reports (Ex. DF-1 in this case, Ap. 264a et seq.) which shows the current New Jersey Taxes and the principal of back taxes and interest thereon for each of the five base years in question, the total taxes assessed against appellant by New York, New Jersey, Pennsylvania and other states, and the system Net Railway Operating Income as reported to the Interstate Commerce Commission and such income before state and local taxes as well as the system Net Railway Operating Income before taxes allocated to New Jersey, New York and Pennsylvania. A graphic picture of the impact of the New Jersey taxes on

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appellant as assessed in the assessments under review is obtained by an examination of this statement.

This statement shows that for the year 1945 Appellant's System Net Railway Operating Income allocated to New Jersey before state and local taxes was $2,952,338. In that year Appellant's property taxes as assessed by New Jersey were $1,855,891. Its franchise taxes as assessed by the Director of the Division of Taxation were $1,601,826, a total of $3,457,717, or an amount $505,379 in excess of Appellant's Net Railway Operating Income allocated to New Jersey before taxes.

Had the franchise excise tax been assessed on Appellant's Net Railway Operating Income for 1944 as reported to the Interstate Commerce Commission, the franchise tax for 1945 would have been $516,858 (*supra*, p. 6). The Director actually assessed a franchise tax of $1,601,826, or an increase in franchise taxes for the year 1945 of $1,084,968 (page 6, *supra*).

The action of the Director in thus increasing Appellant's franchise taxes for 1945 actually took for that year from Appellant $505,379. of Appellant's Net Railway Operating Income earned in New York and Pennsylvania. Had the franchise tax for 1945 been $516,858 (assessed on Net Railway Operating Income as reported to the Interstate Commerce Commission) Appellant would have had from the income allocated to New Jersey before taxes a sufficient amount to discharge its tax liability for the year to New Jersey and something left over to apply on account of fixed charges.

The annexed statement also shows that in the 5-year period under consideration Appellant paid to New Jersey an aggregate of current and back taxes amounting to $28,091,774, of which $15,238,445 were current taxes for said years. These taxes were in part based on an allocation factor of slightly in excess of 27%. It will be noted that Pennsylvania with an allocation factor of slightly in excess of

28% during this period assessed Appellant a total of $424,540, and New York with an allocation factor of nearly 44% assessed a total during this period of $7,169,182.

Mr. Jonas, Appellant's Comptroller, was asked what the effect upon Appellant would be if the states of New York and Pennsylvania assessed a tax on Appellant as New Jersey did and he replied: "We could not remain in business very long under such a taxing system" (Ap. 201-A 203-a).

The annexed statement shows how true this is!

This case differs substantially from any case heretofore before the court, as we are advised. The State statute takes as a pot for division the Net Railway Operating Income of an interstate system. Appellant would not question this statute if it were applied as written, because in that event the State would be taxing its proper proportion of the interstate earnings, i.e. the proportion that the miles of track in the State bear to the total miles of track of the entire system. In *Southern Railway Co.* v. *Kentucky*, 274 U. S. 76 (1927) the assessment was set aside because too large a proportion of the earnings of the railroad were taken by improperly increasing the miles of track of the system in Kentucky. In the case at bar the same result was achieved by arbitrarily increasing the size of the pot for division. This was accomplished by the tax assessor and the courts of New Jersey (a) by disregarding the fact that appellant does and is required by the Interstate Commerce Commission to keep its books on the accrual system of accounting, and (b) by denying appellant's right to accrue in proper accounts charges that appellant was required to place therein by both sound accounting principles and the Interstate Commerce Commission rules and regulations.

In order to increase the State's "take" from the interstate carrier, the Director, Division of Taxation, in clear derogation of the plain language and intent of the taxing

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statute as shown by the legislative committee report (*supra* p. 12), arbitrarily increased appellant's system net railway operating income from $6,420,112 to $12,683,543 for the year 1944 and from $2,347,900. to $5,702,879. for the year 1945 (pp. 7 and 8 *supra*). Moreover, every dollar of accruals that were disallowed by the Director, Division of Taxation, had been paid in the base year to the State of New Jersey itself, which necessarily takes the position that it can have its cake and eat it too. One instance of the unfairness of the position taken by the State is that when the New Jersey courts held in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, that the interest on the back taxes owed by the railroads was a part of the tax which had vested in the State and which could not be forgiven to the railroads in the Tax Settlement Act (Chap. 290, P. L. 1941) after this interest had been paid to the State and the State attempted to keep it for its own purposes, the City of Jersey City claimed that the interest was distributable to the municipalities of the State in the same way and manner that the principal of the taxes is distributable, and in *Jersey City* v. *Zink* 133 N.J.L. 437 (1945) the Court of Errors and Appeals held that the interest was a part of the tax and distributable as such. Appellant, with the approval of the Interstate Commerce Commission, followed this rule of New Jersey law as established by the highest court in the State which authorized appellant to account for the interest thus paid to the State as taxes. The Supreme Court in the case at bar held that it was not the intention of the Legislature to permit interest on back taxes to be accrued as "Railway Tax Accruals." Accordingly, the same money which was received by the State as taxes and distributed to the municipalities of the State as taxes may not be accrued on the books of the railroads that paid it as taxes. Due process of law is hardly accorded by this method of treating a taxpayer.

It would seem that the action of the State authorities in

this case results, in effect, in nothing less than an improper direct tax upon the gross income of interstate commerce earned by appellant in New York and Pennsylvania as well as in New Jersey.

Fargo v. *Stevens*, 121 U. S. 230 (1887);
Postal Telegraph Cable Co. v. *Adams*, 155 U. S. 688 (1895);
Galveston &c. Railway Co. v. *Texas*, 210 U. S. 217 (1908);
Crew Levick & Co. v. *Pennsylvania*, 245 U. S. 292 (1917);
American Manufacturing Co. v. *St. Louis*, 250 U. S. 459 (1919);
Atlantic Coast Line R. Co. v. *Daughton*, 262 U. S. 413;
Norfolk & Western Railway Co. v. *North Carolina*, 297 U. S. 682, 685 (1936);
Southern Pacific Co. v. *Arizona*, 325 U. S. 761 (1945);
Morgan v. *Virginia*, 328 U. S. 373 (1946);
Freeman v. *Hewit*, 329 U. S. 249 (1946);
Central Greyhound Lines v. *Mealey*, 334 U. S. 653 (1948).

The unconstitutional result was reached not by a strict application of the Tax Act as written, but by capricious and arbitrary action of the assessor, supported by the State courts, through disregarding the established rules of accrual accounting, and the rules and regulations which control an interstate carrier. The arbitrary action of the Director doubled the Net Railway Operating Income of appellant for the years 1944 and 1945, but in each one of the years under review augmented it far beyond what it should be by not allowing appellant the benefit as deductions from gross revenue of monies actually paid to New Jersey for taxes. The result is to load the interstate commerce in which appellant is engaged with an unreasonable burden that the commerce clause was designed to prevent.

Philadelphia &c. Steamship Co. v. *Pennsylvania*, 122 U. S. 326 (1887).

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As Mr. Justice Cardozo said in *Norfolk & Western Railway Co.* v. *North Carolina*, 297 U. S. 682:

> "A formula not arbitrary on its face or its general operation may be unworkable or unfair when applied to a particular railway in particular conditions."

It is respectfully submitted that the statute as applied by the Director, Division of Taxation, with the approval of the New Jersey courts operates both as an unreasonable burden on the interstate commerce in which appellant is engaged, contrary to the commerce clause of the Constitution of the United States, and also operates to deny appellant due process of law.

Union Tank Line Co. v. *Wright, Comptroller General of Georgia*, 249 U. S. 275;
Hans Rees' Sons v. *North Carolina*, 283 U. S. 123;
Freeman v. *Hewit*, 329 U. S. 249;
Central Greyhound Lines v. *Mealey*, 334 U. S. 653.

The following statement by Mr. Justice Roberts in *Schuylkill Trust Co.* v. *Pennsylvania*, 296 U. S. 113, 119; 80 L. ed. 91, 97 (1935) is pertinent:

> "We give great weight to the characterization of a tax, or the interpretation of a state law, emanating from the highest court of the state, but where a federal question is involved we are not bound by the label attached to the tax or the character ascribed to the law. We must determine for ourselves the true nature of the tax by ascertaining its operation and effect."

Respectfully submitted,

JAMES D. CARPENTER,
Attorney for and of Counsel with Appellant,
75 Montgomery Street,
Jersey City 2, N. J.

Dated: December 12, 1949.

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New Jersey State and Local Taxes Compared with Allocated N.R.O.I. Before All State and Local Taxes Years 1941-1945

System State and Local Taxes Charged Railway Tax Accruals—New Jersey	1941	1942	1943	1944	1945	Total
Property Tax—Current Year	$ 1,673,259	$ 1,884,259	$ 1,868,021	$ 1,864,175	$ 1,815,369	$ 9,105,083
" " —Years 1934-40—Principal	800,000	1,200,000	1,200,000	1,230,279	.....	4,430,279
" " —Years 1934-40—Interest	.....	.....	.....	4,932,625	2,845,163	7,777,788
" " —Year 1939 —Principal	.....	.....	.....	89,960	.....	89,960
" " —Year 1939 —Interest	.....	.....	.....	24,400	.....	24,400
" " —Year 1941 —Principal	.....	.....	.....	.....	530,902	530,902
Franchise Tax	287,694	1,149,425	1,339,755	1,517,062	1,581,675	5,875,611
Municipal Taxes	80,168	65,239	40,444	31,953	31,859	249,663
Miscellaneous Taxes	1,053	1,394	1,139	2,085	2,417	8,088
Total New Jersey Taxes	$ 2,842,174	$ 4,300,317	$ 4,449,359	$ 9,692,539	$ 6,807,385	$28,091,774
New York—Total	1,365,125	1,418,231	1,404,699	1,433,984	1,547,143	7,169,182
Pennsylvania—Total	28,377	155,639	106,646	51,990	81,888	424,540
Other States—Total	561	732	2,532	4,547	6,631	15,003
Total System State and Local Taxes	$ 4,236,237	$ 5,874,919	$ 5,963,236	$11,183,060	$ 8,443,047	$35,700,499
System Net Railway Operating Income Reported to Interstate Commerce Commission	10,125,797	11,648,816	11,181,280	6,420,112	2,347,900	41,723,905
System Net Railway Operating Income Before State and Local Taxes	$14,362,034	$17,523,735	$17,144,516	$17,603,172	$10,790,947	$77,424,404
System Net Railway Operating Income Before State and Local Taxes Allocated to Following States on Basis of all Track Miles Operated in State:						
New Jersey —Mileage Percent	27.92%	28.05%	27.7885%	27.6982%	27.3594%	
—Allocation	$ 4,009,880	$ 4,915,408	$ 4,764,204	$ 4,875,762	$ 2,952,338	$21,517,592
New York —Mileage Percent	43.09%	43.44%	43.9035%	43.9845%	44.1545%	
—Allocation	6,188,600	7,612,310	7,527,042	7,742,667	4,764,689	33,835,308
Pennsylvania—Mileage Percent	28.99%	28.51%	28.3080%	28.3173%	28.4861%	
—Allocation	4,163,554	4,996,017	4,853,270	4,984,743	3,073,920	22,071,504
Total	$14,362,034	$17,523,735	$17,144,516	$17,603,172	$10,790,947	$77,424,404

New Jersey Taxes As Reassessed	Year 1942	Year 1943	Year 1944	Year 1945	Year 1946	
Property						

APPENDIX

SUPREME COURT OF NEW JERSEY, SEPTEMBER TERM, 1949

Nos. A 1 and A 2

(A 1)

DELAWARE, LACKAWANNA and WESTERN RAILROAD COMPANY, *Appellant,*

vs.

DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, et al., *Respondents*

(A 2)

WALTER P. GARDNER, Trustee of the Property of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Appellant,*

vs.

DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, et al., *Respondents*

Argued September 19, 1949; decided October 17, 1949.

On appeal from the Superior Court, Appellate Division, whose opinion is reported in 2 N. J. Super, 93.

Mr. David I. Mackie, of the New York Bar, argued the cause for appellant Delaware, Lackawanna & Western Railroad Company, (Carpenter, Gilmour & Dwyer, attorneys).

Mr. James D. Carpenter argued the cause for appellant Walter P. Gardner, Trustee of the Property of The Central Railroad Company of New Jersey.

Mr. Benjamin C. Van Tine argued the causes for respondents, (Mr. Thedore D. Parsons, Attorney General of New Jersey, attorney).

Mr. Frank P. McCarthy argued the cause for respondent, City of Jersey City, Mr. John B. Graff and Mr. Jacob J. Levy on the brief.

The opinion of the Court was delivered by

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OLIPHANT, *J.*:

These are appeals from judgments of the Appellate Division of the Superior Court affirming judgments of the Division of Tax Appeals, Department of Taxation & Finance, against the Delaware, Lackawanna and Western Railroad Company for the tax years 1942 to 1946 inclusive and against the Central Railroad Company of New Jersey for the tax year 1946.

The former company will be referred to as the Lackawanna and the latter as the Central.

The Lackawanna appeal involves (1) items of back taxes claimed to be proper deductions in years other than the years in which the taxes were due and payable; (2) items of interest paid on account of default in payment of principal taxes and claimed to be proper charges to the railroad tax accrual accounts in the years in which they were paid; and (3) an item representing an amount paid under protest and later refunded, which the Lackawanna claims to be a proper accrual against its 1946 operating income.

The Central appeal involves the last two items referred to in the Lackawanna appeal, interest payment and the payment of an amount ultimately found not to be due. Central makes no claim for deductions for items of back taxes it having charged all its taxes to current accounts as such taxes became due and payable, notwithstanding it was contesting its liability for a substantial portion of such taxes. The several items will be discussed in the order set forth above.

The Back Taxes

As was pointed out in *Norton vs. State Board of Tax Appeals*, 134 N. J. L. 57 (E. & A. 1946), the tax levied on railroad property had for years been continuously in litigation and large amounts of these taxes were in default. In 1941 a new method of taxing such property was enacted, P. L. 1941, Ch. 291. This act was amended the following year by P. L. 1942, Ch. 169 (N. J. S. A. 54:29 A-1 et seq.). These laws in substance provided for a combination property tax and franchise excise tax computed in a given year on the basis of the *net operating income* of a railroad sys-

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tem for the preceding calendar year. The tax was not a property tax upon the net income itself but rather an excise tax measured by the net operating income of the preceding year and we are here concerned with whether items of back taxes are properly chargeable as deductions from the operating revenue of years other than that against which such taxes were levied and during which they became due and payable.

Clearly net operating income for a given year cannot be determined by deducting unpaid taxes of prior years or the accrued interest upon such unpaid taxes. The excise being measured by the net operating income for the prior year, this necessarily excluded all items of debit not related to that year's operation.

The argument of appellants proceeds on the hypotheses that the Act of 1941 required the State Tax Commissioner to allow as deductions in determining the next preceding year's net operating income any amounts of back taxes permitted by the Interstate Commerce Commission to be included in current operating income accounts. This interpretation would defeat the legislative purpose. It would put a premium on defaults in the payment of taxes by thereby decreasing the tax burden.

Lackawanna defaulted in payment of its 1933 taxes. In 1939 the litigation concerning these taxes was ended and payment in the amount equal to unpaid principal only was made. Lackawanna also defaulted in payment of taxes for the years 1934 to 1940 inclusive. The determination of the tax litigation for these years was finally determined in 1941 when the United States Supreme Court denied *certiorari*. From 1933 to 1940 Lackawanna paid a portion of the tax levied in each year but charged to current accounts an amount in excess of that which it paid although the whole of the unpaid amount was in litigation. As was pointed out in *Norton vs. State Board*, supra, and as again disclosed by the instant record, during all the period from 1932 to 1940 in which railroad taxes were being contested and litigated certain railroad companies accrued all of their current taxes in the years in which they were levied, while others accrued only the uncontested portion thereof. That Lackawanna's

treatment of such items was not orthodox is disclosed by the various certificates covering the audits for the years in question.

When in 1941 the litigation concerning the 1934-1936 taxes terminated Lackawanna began to charge back taxes in the amount of approximately $5,900,000 to current accounts at the rate of $100,000 per month. An examiner for the Interstate Commerce Commission questioned this method of charging such items but in August, 1942, that body gave special permission for such treatment of the item of back taxes.

The letter of Lackawanna requesting such permission is informative. The letter states that such an unusual item should not be placed in the 1941 operating accounts as this would distort them. That such was still the opinion of Lackawanna's comptroller and its auditor several years later is disclosed by the record.

We might well inquire, from the Interstate Commerce Commission's viewpoint, what does distort an account and whether since the State is concerned with determining the net operating income of a railroad for tax purposes, anything not properly a charge against a given year would not distort the account as far as the State of New Jersey is concerned? We do not have to answer that question. In the definition of income accounts contained in the Interstate Commerce Commission's regulations will be found the answer. The income accounts are designed to show as nearly as possible the earning experience of a railroad for the fiscal year covered by the annual report. As a matter of expediency, because there is no method for amending the reports, items for past years are of necessity permitted to be charged to accounts of later years. But such accounts are tagged by the regulations as "delayed items" and are covered by special instructions.

That Lackawanna charged the back taxes as "delayed items" is clearly shown by its own testimony. Obviously "delayed items", items covering the back years' taxes, are not current items. It is idle to contend the Legislature intended the inclusion of such back taxes in computing next preceding year's net railway operating income.

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We re-affirm what was said in *Norton* vs. *State Board*, supra, at p. 63 "When the Legislature used the words 'railway tax accruals' it meant something more than mere Interstate Commerce Commission permission to include an item in a bookkeeping account or a report. It meant something specific. It meant the type of item that on the date of the passage of the act went into such account as a matter of course. It meant current taxes. *In re Reduced Rates, 68 Interstate Commerce Commission 676*, we find (at p. 683):

"Under our system of accounts all charges to the account 'railway tax accruals' are deducted from railway operating revenues before arriving at railway operating income, and all State and Federal taxes, income or other, relating to carriers' railway property, operations, and privileges, are charged to that account. This method of accounting was recently sanctioned by the Supreme Court of the United States in Galveston Electric Co. vs. City of Galveston, 258 U. S. 388", and at p. 62 that "tax accruals means the current taxes for the particular year which have been assessed in conformity with law, e.g., the amount certified by the tax assessor."

Appellants assert the action of the Director of the Division of Tax Appeals was, in effect, an arbitrary increase of the operating income, and constituted an assessment not only attributable to New Jersey, but actually upon the earnings of the railroad realized in other states in which the system operates. It is claimed such action constituted an unreasonable burden upon interstate commerce and operates as a denial of due process. The point is not well taken.

Where operating income is taken as the franchise base, it cannot exceed the portion fairly allocable to New Jersey, but this principle is not violated by confining the tax base to the income actually earned during the particular year. It is not a tax upon the earnings but an excise measured by the earnings, and the base does not violate the principle.

In determining "net operating income" we find no merit in the contention the Legislature had in mind the figure as fixed by the Interstate Commerce Commission. Obviously

this would constitute an unlawful delegation of legislative power in the sense that the net income would depend upon the action of the Commission from time to time. *Township of Bernards* vs. *Allen, 61 N. J. L.*, 228 (E. & A. 1897); *Hoboken* vs. *Martin*, 123 N. J. L. 442 (E. & A. 1939); *Veix* vs. *Seneca Bldg. & Loan Asso.*, 126 N. J. L. 314 (E. & A. 1941); *Norton* vs. *State Board*, supra. That Commission did not generally permit the deduction of interest on tax arrears in the calculation of net income for a particular year, although it apparently permitted the roads operating in New Jersey to do so on the supposed authority of Wilentz vs. Hendrickson, 135 N. J. Eq. 244 (E. & A. 1944).

The action of the Interstate Commerce Commission in permitting the Lackawanna to allocate the unpaid and unapproved portion of the taxes for 1934 to 1940 in the years 1941 to 1944 has no bearing upon the meaning and intent of our statute. The returns made to the Interstate Commerce Commission are not made for the purpose of taxation under the State statute. The holding of the former Court of Errors and Appeals in the *Norton case* relative to this point is dispositive of it.

Appellants further make much of the fact that their system of accounting was proper under the authority of the United States Supreme Court in *Dixie Pine Products Co.* vs. *Commissioner of Internal Revenue*, 320 U. S. 516 (1944), 88 L. Ed. 270, 64 S. C. 364 and *Security Flour Mills Co.* vs. *Commissioner of Internal Revenue*, 321 U. S. 281 (1944), 88 L. Ed. 725, 64 S. C. 596. As pointed out in the *Norton case* the Federal Income Tax was involved in these cases and, in both, the attack was upon the validity of the tax itself, not the amount of the assessment. A further reason why these cases and their like are not controlling is that in income tax cases the question involves net corporate income. Here the State is not interested in the net corporate income of the railroads but in their net operating income, which is the statutory yardstick.

The Interest Items

Because of default in payment of 1933 to 1940 taxes Lackawanna became liable for large interest payments. Central also became liable for large amounts of interest

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by reason of default in payment of its 1932 to 1940 taxes and for interest due because of payment of certain taxes of the New York & Long Branch Railroad Company for which Central was liable.

In 1941 the Legislature sought to forgive the interest payment due on account of the default in payment of taxes by the several railroad companies operating in the State, P. L. 1941, Ch. 290 as amended by P. L. 1942, Ch. 241. These acts were held to be unconstitutional in *Wilentz* vs. *Hendrickson*, supra. Thereafter both Lackawanna and Central paid the interest amounts. Lackawanna now seeks to charge such interest payments against 1944 and 1945 operating income and so reduce 1945 and 1946 franchise excise tax. It contends the holding in *Wilentz* vs. *Hendrickson*, supra, is that interest is a part of the tax and therefore is properly chargeable to the railway tax accrual account for the year in which the interest was paid. Central makes a similar claim.

The essence of the holding in that case was that interest was compensation for deprivation of the principal, that as it occurred it became a vested right just as much as the principal of the tax, and the obligation thereby arising could not be remitted under the Constitution for that would constitute a gift of public funds. The fact it becomes a fixed obligation which may not be forgiven does not have any bearing upon the meaning of the statutory provision providing for the assessment of the excise.

To determine the legislative intent as to the statute under consideration we must look to the dates July 22, 1941 and May 21, 1942 when the original act and the amendment were approved and on such dates such items were not properly chargeable to operating income accounts.

In 1941 and 1942 amounts payable on account of default in payment of taxes were covered by cases A-38 and A-179 of the Interstate Commerce Commission Accounting Bureau. The former provided that when taxes are not paid promptly the additional amounts assessed under Federal and State Statutes for failure to pay such taxes when due should be charged to Account 547 "Interest on Unfunded Debt" and the latter provided that interest paid on deferred

taxes should be charged to Account No. 547 "Interest on Unfunded Debt".

Thus, whether it be called penalty or interest or additional taxes, an amount payable on account of default in payment of taxes was chargeable to a non-operating income account. There is nothing in *Wilentz* vs. *Hendrickson*, supra, or any other authority which holds that the items here in litigation under this point are not payments due because of default in payment. Thus on July 22, 1941 and May 21, 1942 such items belonged in the non-operating account "Interest on Unfunded Debt".

We reiterate what was said in *Norton* vs. *State Board* supra, "In determining whether an item is a proper deduction as a 'railway tax accrual' within the legislative intent as expressed in the Railway Tax Act, we believe the following tests should be applied: 1—Is the item of the type that prior to May 1, 1942, would have been customarily and in accordance with recognized accounting practices of the time included in the railway tax accrual account? 2—It having been determined that the item is of the proper type, is the year against which the item is sought to be charged the proper year? The first test is important for the obvious reason that the Legislature could not have intended that anything other than taxes as actually assessed and levied should be included in the tax accrual account. At the date of the passage of the act this appears to have been the policy of the Interstate Commerce Commission. The second test is necessary to prevent a manipulating of accounts to the detriment of the state's revenue." (p. 64).

The interest items do not meet the first test.

It is significant that the Legislature, when on April 29, 1948, it amended the Railroad Tax Act, P.L. 1948, Ch. 40, and therein re-enacted the provisions concerning tax accruals as contained in the act under review, acquiesced in and adopted the construction of the Act as placed upon it by the Court of last resort in the *Norton case* which had been filed January 1, 1946, more than two years prior to the amendment. Under such circumstances it must be assumed the Legislature acted with the judicial definition and construction in mind. *American Woolen Co. vs. Edwards,*

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Comptroller, 90 N.J.L. 69 (Sup. Ct. 1916); affd. 90 N.J.L. 293 (E. & A. 1917).

With particular reference to interest paid by Central on account of default in the payment of taxes owed by the New York and Long Branch Railroad Company we reach the same conclusion. Central was obligated by contract to pay 50% of the taxes and interest owing by the New York and Long Branch Railroad Company. The payment of these taxes was properly chargeable to "Joint Facility Rents", Account No. 541 which account provides for inclusion therein of "amounts paid or payable by the accounting company in reimbursement for taxes on property jointly used shall be charged to this account."

There is no provision in the definition for interest payments on account of default because like all other interest payments such are not a charge to operating income accounts. Nothing has been shown to disclose a legislative intent to have the New York and Long Branch interest payment treated other than as a non-operating income charge.

Additional 1941 Taxes

In 1945 the former Supreme Court held the Railroad Tax Act of 1941 to be unconstitutional for the tax year 1941, *Jersey City vs. State Board*, 133 N.J.L. 202. Immediately thereafter Lackawanna paid an additional amount representing increased 1941 principal taxes upon the understanding that the sum paid would be repaid to it if it should be determined that the Supreme Court was in error. Central some time later in 1945 paid an additional amount of principal tax and a further amount determined by it to be due as interest. The order of the United States District Court directing such payments provided that in the event the Supreme Court was in error the payments made would be credited on future taxes.

On May 3, 1946 the former Court of Error and Appeals reversed the Supreme Court, *Jersey City vs. State Board of Tax Appeals* 134 N.J.L. 239, and held the Railroad Tax Act of 1941 to be wholly constitutional. Immediately thereafter, the State repaid Lackawanna the additional sum paid on its 1941 taxes. Provision was also made for cred-

iting the additional payment of 1941 taxes and interest to the 1946 taxes of Central.

Both Lackawanna and Central now claim that the provisional payments were 1945 railway tax accruals in computing its 1946 franchise excise tax. We agree with the State Tax Commissioner that such items were not properly deductible as railway tax accruals in computing the 1946 franchise tax for the reason that such amount was never due and payable. Even if a sum is properly deductible when the tax is computed and thereafter it is determined not to be due and payable the Tax Commissioner is required to re-compute the tax to eliminate any such item. The statutory provision giving the Tax Commissioner the power to recompute a tax for a period of five years was designed to cover just such a contingency. It was the legislative purpose to have the State share with the railroad companies in good earning years and the purpose is only accomplished if we determine the true net operating income for each respective accounting period.

The judgments are affirmed.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 502

THE DELAWARE, LACKAWANNA AND WESTERN RAILROAD COMPANY,

Appellant,

vs.

DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, *et al.*,

Appellees.

APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF IN SUPPORT OF JURISDICTION

JAMES D. CARPENTER,
Attorney for and of Counsel with Appellant,
75 Montgomery Street,
Jersey City 2, N. J.

DAVID I. MACKIE,
ELMER J. BENNETT,
MILTON A. DAUBER,
on the brief.



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Supreme Court of the United States
OCTOBER TERM, 1949

THE DELAWARE, LACKAWANNA AND WESTERN RAILROAD COMPANY, *Appellant,* *vs.* DIVISION OF TAX APPEALS, NEW JERSEY STATE DEPARTMENT OF TAXATION AND FINANCE, *et al.,* *Appellees.*	No. 502

APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF IN SUPPORT OF JURISDICTION

POINT I

Appellant Has Drawn into Question before the Supreme Court of New Jersey the Validity of a State Statute.

It is and has consistently been the claim of appellant that the Railroad Tax Act of New Jersey, Ch. 291, P. L. 1941, as amended by Ch. 169, P. L. 1942, is unconstitutional as construed and as applied to the facts presented by the record of this case. Such a claim gives this Court jurisdiction on direct appeal under 28 U. S. C. § 1257 (2) even though the appellant does not allege the total invalidity of the statute under attack. *Dahnke-Walker Milling Co.* v. *Bondurant,* 257 U. S. 282 (1921); *Fiske* v. *Kansas,* 274 U. S. 380 (1927); *Blodgett* v. *Silberman,* 277 U. S. 1 (1928).

In the *Silberman* case the State of Connecticut assessed a Transfer Inheritance Tax upon the decedent's interest in a New York partnership. The case was viewed as drawing into question the validity of a statute as construed and applied even though the constitutional problem arose, not by reason of the wording of the statute or any judicial gloss imposed thereon, but rather because of its application by the local officers to the particular facts of the case, and a direct appeal was allowed. It is, therefore, of no consequence here that appellant urged below the severability of the unconstitutional construction placed upon New Jersey's Railroad Tax Act by the tax assessor and the New Jersey Courts. It suffices for the purpose of the present proceeding that appellant has claimed that a particular construction and application of the statute conflicts with the Federal Constitution.

The only question then remaining is whether the Supreme Court of New Jersey was sufficiently apprised of appellant's claim to afford that Court the opportunity of ruling upon it. Appellant's jurisdictional statement and the appendix submitted therewith show that the pleadings in the Division of Tax Appeals and in the Appellate Division of the New Jersey Superior Court clearly and precisely and in so many words alleged that the *construction* of the statute adopted by the tax assessor was unconstitutional. Jurisdictional Statement, pages 12 and 13. These pleadings were before the State Supreme Court as part of the record in the instant case. It is well settled that a federal question is sufficiently presented below if the pleadings in the case clearly raised it. *Magwire* v. *Tyler*, 8 Wall. 650 (U. S. 1869); *American Sugar Refining Co.* v. *Louisiana*, 179 U. S. 89 (1900); accord, *Williams* v. *Kaiser*, 323 U. S. 471 (1945). The respondents, however, have taken the position that appellant's refusal to urge the total invalidity of the Railroad Tax Act constitutes a failure to urge the invalidity of a statute or of a statutory construction. In so contending they have ignored the pleadings of record in the instant case. They have, moreover, sought to substantiate their

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claim by reference to matters which are not of record here. They have quoted a portion of appellant's brief in the Supreme Court of New Jersey. It is our understanding of the settled rule in this Court that the briefs and arguments of counsel below may not be considered in determining the existence or absence of appellate jurisdiction. *Lynch* v. *New York ex rel. Pierson*, 293 U. S. 52 (1934).

It might be objected that this settled rule should not apply to such matter as the "Statement of Questions Presented". See Respondent's Statement Opposing Jurisdiction, Pages 5 and 6. Despite the importance which the rule of the New Jersey Supreme Court attaches to the Statement of Questions Presented, appellant submits that no rule of that Court nor any legislation of the State of New Jersey makes such Statement of Questions Presented part of the record itself. Therefore, upon the authority of *Fisher's Lessor* v. *Cockerell*, 5 Pet. 248 (U. S. 1831) this Court should decline to treat the Statement of Questions Presented as of record for determining its own jurisdiction. In that case it was held that although pleadings are part of the record at common law this Court will not treat an assignment of error from an inferior State Court to the ultimate Court of review within the State as establishing that federal questions were presented below unless such assignments of error are expressly made part of the record by a state statute.

In the event, however, that this Court should be disposed to look to the briefs of counsel in determining its own jurisdiction, appellant then submits that the briefs filed below support jurisdiction in the instant case. We have already seen that the pleadings draw into question the validity of the statute. It is true that the Statement of Questions Presented in appellant's brief in the Supreme Court of New Jersey does not use any such form of words as "the statute is unconstitutional". Nonetheless, an examination of the record and of all the briefs submitted clearly shows that constitutionality of the statute as such

and not merely validity of the assessment was in issue and was fully argued. At page 27 of appellant's brief the general heading for Point I of the argument was stated as follows:

> "The construction of the 1941 Railroad Tax Act as made by the Director, Division of Taxation imposes an unconstitutional burden on the interstate commerce in which appellant is engaged and also operates as a denial of due process."

The answering brief of Respondent, State of New Jersey met appellant's brief upon this ground and beginning at Page 30, specifically argued the issue under a point heading reading as follows:

> "The railway tax law of 1941 does not impose an unconstitutional burden on interstate commerce and does not operate as a denial of due process."

The answering brief of Respondent City of Jersey City also argued this issue beginning at page 44 under the following point heading:

> "The New Jersey Railroad Tax Act of 1941, as construed by the Director of the Division of Taxation, does not offend any provision of the United States Constitution."

The respondent in its statement opposing jurisdiction has relied upon the asserted rule that an attack upon a specific assessment under a tax law does not create a case within the appellate jurisdiction of this Court. Appellant submits that the cases cited in support of this supposed rule do not justify respondent's position. The real principle involved in such cases as *Wilson* v. *Cook*, 327 U. S. 474 (1946) and *Charleston Federal Savings and Loan Association* v. *Alderson*, 324 U. S. 182 (1945) is that an attack directed merely to the assessment cannot sustain appellate jurisdiction where the attack may have been predicated upon some illegal act of the assessing officer (*e.g.*, systematic discrimination in valuation of property) rather than

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upon the necessary operation of the statute as construed and applied by the Courts of the State. This vice does not inhere in the case at bar. As pointed out above, appellant has left no doubt as to the basis for its constitutional claim. Appellant has always asserted that it is the construction of the statute, and not merely the action of the assessing officer, which denies it a federal right.

Similarly, the case at bar is not ruled by *Memphis Natural Gas Company* v. *Beeler*, 315 U. S. 649 (1942). In that case appellant had alleged in the State Court merely that the assessment and the threatened levy violated its rights under the Commerce Clause. In the instant case appellant has specifically pointed to the statute as impairing its rights.

Respondent has also relied upon *Ferry* v. *King County*, 141 U. S. 668 (1891) and *French* v. *Taylor*, 199 U. S. 274 (1905). In the former case, appellant merely sought an adjudication by this Court as to whether the Supreme Court of Washington had correctly interpreted the intention of the old Territorial Legislature as expressed in its practice act. In the case at bar, appellant can no longer question the construction which the Supreme Court of New Jersey has placed upon the Railroad Tax Act; rather, appellant denies the power of the State to enact and enforce the Act as so construed.

In the case of *French* v. *Taylor*, appellant attacked a tax deed upon the ground that it had been issued under a form of procedure which denied him due process of law. Although Mr. Chief Justice Fuller stated in the opinion that the case was one in which the validity of a statute had not been drawn in question, appellant respectfully submits that, upon its own opinion, the Court decided only that the claim of due process there made did not present a substantial federal question. In the light of precedents cited by appellant going to support the jurisdiction of this Court in the case at bar, *French* v. *Taylor* should not be considered as authorizing a dismissal.

The record in the case at bar establishes that appellant has specifically and clearly, and conformably to the decisions of this Court, drawn into question before the Supreme Court of New Jersey the constitutionality, under the Commerce Clause and the Fourteenth Amendment, of the Railroad Tax Act of 1941 as construed and applied by the State Court. In the event, however, that this Court should determine otherwise, appellant requests that the moving papers be considered as a petition for *certiorari* in conformity with Section 2103 of the Judicial Code.

POINT II

The Federal Questions here Presented are Substantial.

Introductory

Respondent in its motion to dismiss or affirm has argued that the tax law here under consideration must be sustained for the reason that the franchise tax imposed thereby is merely a tax in lieu of general property taxation. It places its entire reliance upon *Postal Telegraph Cable Company* v. *Adams*, 155 U. S. 688 (1895). Appellant respectfully submits that the franchise excise tax imposed by Article III of Chapter 291, P. L. 1941, as amended by Chapter 169, P. L. 1942, does not in fact impose a tax in commutation of property taxes and for this reason the authority cited by the respondent is inappropriate. We contend that the tax levied under the statute as construed is in form as well as in fact a direct tax on gross revenues derived from interstate transportation. It is, therefore, a prohibited burden upon interstate commerce. We respectfully submit that the Railroad Tax Act of 1941 as construed and applied by the Supreme Court of New Jersey falls within the ban which this court has always maintained against state taxes, whether apportioned or not, which seek to reach gross receipts derived from interstate transportation.

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A.

The New Jersey Railroad Franchise Excise Tax is not a Commutation of Taxes upon Property.

The contention now made by the Attorney General of the State of New Jersey would seem to be at variance with the characterization which the Legislature and the courts of the state have placed upon this tax law. It is provided in Section 13 of Chapter 291, P. L. 1941 that the franchise tax is levied upon the railroads for the privilege of exercising their franchises within the state. The Supreme Court of New Jersey, in the opinion now under appeal, has characterized the franchise tax as follows:

> "The tax was *not a property tax* upon the net income itself but rather an excise tax measured by the net operating income of the preceding year . . ." (Italics supplied) (p. 34, ll. 1 to 4, Appendix to Appellant's Jurisdictional Statement)

Nomenclature aside, however, the franchise excise tax can not be considered as a commutation of property tax for the reason that the property value of the franchise is already taxed. This is accomplished by attributing going-concern value to the various items of real and tangible personal property which are taxed under Article II of the Railroad Tax Act.

Under the system of Railroad taxation in effect in the State of New Jersey until enactment of Chapter 291, P. L. 1941, all railroad property was divided into four classes and each class was required to be assessed and returned for taxation separately. Ch. 208, Section 3, P. L. 1888, as amended, N. J. R. S. 54:22-1 (1937). This Act specifically required that the railroad franchise, which was included in the so-called Class IV property, should be evaluated separately and apart from the tangible property. The tax assessors were forbidden to value tangible items with reference to their going-concern value. *Long Dock Company* v.

State Board of Assessors, 78 N. J. L. 44, 73 Atl. 53 (Sup. Ct. 1909), *aff'd*, 79 N. J. L. 604, 80 Atl. 1135 (E. & A. 1910).

Neither the legislature nor the courts of the state were unaware that the property value of a franchise may be reached by assessing tangible items at their going-concern value. In fact, the statements of the Supreme Court in the *Long Dock* case *supra*, at pages 52-53, 73 Atl. at 56-57, recognized that the property value of the franchise and the going-concern value attributable to the tangible property are interchangeable concepts. The reason that the franchise was required to be assessed independently rather than as an element in the value of the other property was that the statute allowed taxes upon right of way, rolling stock and franchise to be retained for state uses while taxes assessed by the state upon so-called second class railway property, consisting primarily of terminal lands and facilities, were to be given to the local taxing district within which the second class property lay. Ch. 208, Sec. 11, P. L. 1888, as amended, N. J. R. S. 54:24-6, 54:24-11 (1937); see *Long Dock Company* v. *State Bd. of Assessors, supra*, at page 48, 73 Atl. at page 55.

The Railroad Tax Act of 1941, Ch. 291, P. L. 1941, which superseded the Act of 1888, made no express provision in Article II thereof, which levied a general property tax on all property used for railroad purposes, for a property tax upon the value of franchises exercised within the state. It might therefore appear that the legislative intention was to commute this particular property tax by imposing, in lieu thereof, the franchise excise in Article III. Nonetheless, appellant submits that the systematic practice of the tax assessors, as sanctioned by the Division of Tax Appeals, has been to assess a general property tax under Article II upon the franchise value. This has been accomplished by assessing real and tangible personal property at its going-concern value.

This practice appears to have arisen almost contemporaneously with the effective date of the Railroad Tax Act of 1941. It received sanction in the case of *Pitney* v.

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Kelly, 21 N. J. Misc. 405, 422, 34 A.2d 547, 556 (St. Bd. of Tax App. 1943). It is most clearly shown, however, in the recent case of *Erie Railroad System* v. *Walsh*, 26 N. J. Misc. 81, 57 A.2d 217 (Div. Tax App. 1948). In that case the railroad contested the amount of the assessment on various classes of its property. As to Class I, or right-of-way property, the Division said:

> "The Director properly valued these lands in the physical condition in which they were held by Erie, taking into consideration work done on the land such as clearing, grading and grubbing. See *Borough of Emerson* v. *State Board*, 6 N. J. Misc. R. 326; 141 *Atl. Rep.* 23. In addition, he ascribed to these parcels a factor of value inherent in them by reason of the particular purpose which they served, namely, as the right-of-way of a going railroad company.
>
> "Erie's witnesses ignored the foregoing considerations necessary for the determination of true value." (26 N. J. Misc. at p. 85, 57 A.2d at p. 220).

A bit further on in its opinion, the Division said, in discussing the proper method of assessing Class II, or terminal facility property, the following:

> "• • • But none of the witnesses [for appellants] in valuing the terminal as a whole considered it from the standpoint of its contribution of value as a waterfront terminus 'assembled and peculiarly adaptable' to the business the terminal serves. See *Long Dock Co.* v. *State Board of Assessors, supra. Additionally, none of the witnesses for Erie or Jersey City considered the value of the terminal from the standpoint of its contribution to the total value of the trunk line railroad system of which it forms a part.*" (26 N. J. Misc. at pp. 94-95, 57 A.2d at p. 225) (Italics supplied)

Thus it clearly appears that the Division has sanctioned taxation of railway property at going-concern value under Article II of the 1941 Act. Of course, this analysis of the history of property assessment in New Jersey is not printed here with the intention of asking the court to correct and revise the attitude of the Division of Tax Appeals toward

the New Jersey railroad tax law. Rather, we wish to point out that contemporaneously with the enactment of Chapter 291, P. L. 1941, which omitted from Article II thereof any provision for taxation of franchise value, the assessing officials adopted a practice, at variance with the established valuation practice, whereby they have imposed a property tax upon the value of the railway franchise in New Jersey. Appellant respectfully submits that this makes it impossible to characterize the franchise excise tax imposed by Article III of the Railroad Tax Act as a commutation of property taxes.

Respondent has urged that the language of the statute itself clearly establishes the "in lieu" character of the tax in question. We submit that respondent has placed an erroneous construction on the "in lieu" provisions of the Railroad Tax Act.

The Act of 1888, Ch. 208, Sections 1 and 2, P. L. 1888, as amended, N. J. R. S. 54:20-2 (1937) provided that taxes imposed thereunder should be in lieu of all other taxes on the property reached by that act. The Railroad Tax Act of 1941 provides in Section 11 that the property tax imposed by Article II shall be in lieu of all other state or local taxation of or measured by property taxable thereunder except assessments for benefits. Similarly, Section 13 provides that the franchise excise tax shall be in lieu of any other tax or taxes of or upon such franchises. A consideration of these provisions in the light of the tax history of New Jersey shows their intention quite plainly. The state has traditionally treated railroad and canal companies as a distinct class for tax purposes. It has always been deemed advisable as a matter of policy to exempt such companies from the general tax laws of the state and to subject them to revenue acts directed to their special business problems. Indeed this is clearly demonstrated in the history of the Railroad Tax Act of 1941, since, as pointed out both by appellant and respondent, the purpose of the new act was to make taxation more responsive to fluctuations in railway revenues. When this is kept clearly in

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mind, it becomes evident that the purpose of the "in lieu" provisions of Articles II and III is to continue the traditional exception of railroad taxation from the general revenue laws of the state. In view of this, and in view of the practical construction which the taxing authorities have placed upon the property tax levied under Article II, it can not be said that the "in lieu" provisions of Article III have any reference to the interrelationship of taxes imposed upon railroads by the Act of 1941. Respondent's assertion that the franchise excise tax is in lieu of property taxes, therefore, not only fails to find support in the language of the statute itself, but it is also affirmatively refuted by the history of assessment under this Act.

B.

The New Jersey Railroad Franchise Excise Tax Must be Characterized as a Direct Tax upon Gross Receipts from Interstate Transportation.

Section 13 of the Railroad Tax Act of 1941 thus describes the tax there levied:

> "An annual excise tax is hereby levied upon all railroads operating within this State for the privilege of exercising their respective franchises, to be computed in the manner hereinafter provided."

Presumably, the franchise here sought to be taxed is the privilege of doing a purely local transportation business. At any rate, appellant in fact does local business, and has no standing to challenge the statute as written.

It is at once apparent however, from a reading of Section 14 of the Act, that the franchise excise base, and therefore the amount of the tax, will be directly proportional to the amount of the road's revenue (derived from both local and interstate business) allocated to New Jersey by the statutory formula. Its effect then is identical with the practical effects of a tax levied directly upon the revenue itself.

Appellant would have no quarrel with the Statute if it were construed and applied so as to reach only that sum which, under sound accounting technique, could be regarded as the net operating income remaining in the hands of the road. The constitutionality of such a tax on or measured by net income is well established. E.g., *Atlantic Coast Line Railroad* v. *Daughton* 262 U. S. 413 (1923).

However, appellant submits that the Courts of New Jersey have so construed the Statute as to make gross receipts the revenue component of the tax base formula. In order to demonstrate this, it is necessary to examine the items of deduction claimed by appellant in the instant case and the attitude which the courts of New Jersey have consistently taken toward such claims. The details as to appellant's claimed deductions are set out in the Jurisdictional Statement at pages 15 through 25 and we shall therefore not repeat them here.

The liability to pay these items was finally determined by judicial decision (except in the case of the settlement payments which were payable in installments by contract with the State pursuant to the Railroad Tax Settlement Act, Ch. 290, P. L. 1941) after litigation.

There can be no doubt that under any recognized system of accounting the items here in question were properly chargeable as deductions in the year when appellant charged them. The authorities which support appellant's procedure are set out at page 25 of the Jurisdictional Statement.

Upon what grounds, then, have the Courts of New Jersey held the items here in question to be improper deductions for purposes of the Franchise Excise Tax?

It is apparent from the opinion of the Supreme Court here on appeal and from the opinion of the old Court of Errors and Appeals in *Norton* v. *State Board of Tax Appeals*, 134 N. J. L. 57, 45 A. 2nd 799 (E. & A. 1946), that the ground of decision was essentially unrelated to the con-

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cept of net income in the accounting sense. In the opinion of the Supreme Court here on appeal the Court said the following things:

> "The argument of appellants proceeds on the hypotheses that the Act of 1941 required the State Tax Commissioner to allow as deductions in determining the next preceding year's net operating income any amounts of back taxes permitted by the Interstate Commerce Commission to be included in current operating income accounts. This interpretation would defeat the legislative purpose. It would put a premium on defaults in the payment of taxes by thereby decreasing the tax burden." • • •
>
> "We re-affirm what was said in *Norton* vs. *State Board,* supra, at p. 63 'When the Legislature used the words 'railway tax accruals' it meant something more than mere Interstate Commerce Commission permission to include an item in a bookkeeping account or a report. It meant something specific. It meant the type of item that on the date of the passage of the act went into such account as a matter of course. *It meant current taxes.*" • • • (Italics added)
>
> "The action of the Interstate Commerce Commission in permitting the Lackawanna to allocate the unpaid and unapproved portion of the taxes for 1934 to 1940 in the years 1941 to 1944 has no bearing upon the meaning and intent of our statute. The returns made to the Interstate Commerce Commission are not made for the purpose of taxation under the State statute. The holding of the former Court of Errors and Appeals in the *Norton case* relative to this point is dispositive of it." (Appellant's Jurisdictional Statement, Appendix, pp. 35, 37 and 38)

In the *Norton* case, the Court said:

> "To determine the legislative intention as to the statute under consideration we must look to the dates, July 22, 1941 and May 8, 1942, when the original act and the amendment were approved. During all of the period from 1932 to 1940 that railroad taxes were being contested and litigated certain

companies accrued all of their current taxes in the years they were levied, while others accrued only the uncontested portions thereof. There was no uniformity. The only thing that is certain is that any company was permitted, as a matter of course, to accrue the whole of the tax in the year in which it was levied, notwithstanding the dispute. *Any rule which would now allow a company to accrue a portion of back taxes would not work for uniformity.*" • • •

"Net operating revenue, *to the minds of the members of the legislature and to the mind of the layman,* without doubt includes a charge for taxes for the year in question, not taxes for years in the past." • • •

"Much reliance is placed by the respondent and the intervenors on the opinion of the United States Supreme Court in *Dixie Pine Products Co.* v. *Commissioner of Internal Revenue, 320 U. S. 516, 64 S. Ct. 364, 88 L. Ed. 270* and on *Security Flour Mills Co.* v. *Commissioner of Int. Rev., 321 U. S. 281, 64 S. Ct. 596, 88 L. Ed. 725,* which followed it. Our Supreme Court used these cases to buttress its opinion. They do not appear to us to be in point. The federal income tax was involved and in both cases the attack was upon the validity of the tax itself, not the amount of the assessment. A holding in a federal income tax case based solely on the construction of the Federal Revenue Acts is not controlling in construing a state law enacted for an altogether different purpose." (Italics added) (134 N. J. L. at pp. 62-63, 64 and 65, 45 A.2d at pp. 802, 803)

Appellant submits that the quoted portions of the opinions establish that the courts in deciding these two cases were not motivated solely or even primarily by a desire to reach a realistic definition of railway net operating income, or to treat the statutory language as intending to tax only that portion of the gross revenues from transportation operations which might properly be said to remain as operating profit in the hands of the railroad. Rather, these opinions show that the highest courts of the State of New Jersey have regarded the policy of uniformity as of over-

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riding importance and that they have construed net income with an eye more to the prevention of any possible tax avoidance than with an eye to ascertaining the true system net operating income of an interstate railroad. In short, appellant submits that in construing the Railroad Tax Act of 1941, the Courts of New Jersey have been essentially indifferent to net railway operating income as an accounting concept and that in order to spare the tax administrator the task of determining in each case whether a claimed deduction from gross operating income was legitimate, it has established a purely arbitrary rule which in the case at bar has resulted in a tax on appellant's gross operating income. The result of the decision of the Supreme Court of New Jersey is that the tax may be levied upon revenues from interstate commerce whether or not the operation of the railway has produced net operating income.

That the tax has so operated is dramatically shown at pages 3 and 4 of the Jurisdictional Statement in behalf of the Central Railroad Company of New Jersey, Appellant in No. 503. In 1945 the Central system reported to the I. C. C. a net operating income of $145,349.00. It should be noted that this was the income for the system as a whole and not merely the fraction allocable to New Jersey. In 1946 because of the deductions disallowed by the Director of the Division of Taxation the road was charged with a franchise excise tax of $422,769.00, based supposedly on net operating income of the previous year. Thus, the Central's franchise tax for New Jersey alone was almost three times as great as its entire system net railway operating income for the tax base year. A tax which operates in this way has all of the vices inherent in a tax which is baldly stated to be on gross receipts. As pointed out by Mr. Justice Pitney in *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321, 328 (1918):

> "The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden

upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude, and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large. Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the states are not exempted by the Federal Constitution because they happen to be engaged in commerce among the states."

In short, the franchise excise tax levied by Article III, Chapter 291, P. L. 1941, as construed by the New Jersey courts, must be characterized as a gross receipts tax. As appellant will demonstrate in Part C, *infra*, the decisions of this Court require that Chapter 291, P. L. 1941, as construed and applied by the Supreme Court of the State, be declared unconstitutional.

C.

The Franchise Excise Tax Imposed by Ch. 291, P. L. 1941, as Construed and Applied, is in Conflict with Applicable Decisions of This Court.

Appellants do not dispute that if the statute were applied as written there would be no question as to its constitutionality. As written, the statute manifests an apparent intention to reach merely the net railway operating

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income produced in the State of New Jersey and remaining in the carrier's hands after all proper operating charges have been deducted or paid. Such a tax is of undoubted validity.

> *Memphis Natural Gas Company* v. *Beeler*, 315 U. S. 649 (1942);
> *Atlantic Coast Line Railroad* v. *Daughton*, 262 U. S. 413 (1923);
> *United States Glue Company* v. *Oak Creek*, 247 U. S. 321 (1918).

We have already seen, however, that the tax here under consideration must be characterized as an attempt to reach directly a part of the appellant's entire gross receipts from interstate commerce. Viewed in this light, the instant case falls squarely within the express facts and holdings of two decisions of this Court.

The first of these is *Galveston, Harrisburg & San Antonio Railway* v. *Texas*, 210 U. S. 217 (1908). In that case the State of Texas levied a tax upon the gross receipts earned by railroad corporations operating within the State. Since the appellant in that case had no trackage outside of Texas, the tax was assessed against its entire receipts. It was therefore not necessary to point out in the opinion that the tax statute was directed only to that proportion of a railroad's gross receipts which its trackage within the State bore to its entire trackage. Nonetheless, such was the fact. The tax presented for adjudication was an apportioned gross receipts tax upon interstate transportation. See Powell, *More Ado About Gross Receipts Taxes*, 60 Harv. L. Rev. 501, 511-512 (1947). This Court found that the Texas gross receipts tax not only made no attempt to use gross receipts as a measure of the going-concern value of the company, but that it was a tax in addition to a general property tax which reached the going-concern value. The court therefore ruled that the tax under consideration was no more than an attempt to levy toll upon the doing of interstate business, and directly in proportion to the volume of

business done. This being so, the tax was necessarily unconstitutional. Since appellant in the instant cases has shown the New Jersey Franchise Excise Tax on railways to be, both by intention and operation, a tax in addition to the general property tax upon going-concern value, we respectfully submit that the case now at bar is governed by the *Galveston Railway* case.

The instant case is moreover identical with *New Jersey Bell Telephone Company* v. *State Board of Taxes*, 280 U. S. 338 (1930), where the State of New Jersey had levied upon all corporations using the public streets a franchise excise to be measured by that proportion of the gross receipts from all sources which their miles of lineage located upon public streets or highways within the State of New Jersey bore to their total miles of lineage everywhere. The point in dispute was the constitutional validity of that tax when it was sought to be levied against any fraction of the appellant's gross receipts from interstate communication. Looking to and interpreting the decisions of the New Jersey Court of Errors and Appeals, this Court found that the tax was not intended as a tax upon property but was rather a direct license tax. Therefore, upon the authority of such cases as *Philadelphia & Southern Mail Steamship Company* v. *Pennsylvania*, 122 U. S. 326 (1887) and *Galveston, Harrisburg & San Antonio Railway* v. *Texas, supra*, this Court invalidated the New Jersey Franchise Tax there in dispute. This Court also found that the apportionment of gross earnings was upon its face an unreasonable and inappropriate measure of the value of the property right which the State contended it was attempting to reach. The same is true in the case at bar, where the tax is entirely out of proportion to the real net operating income of the railroad, and the real relevance of this disproportion is that it indicates a purpose to tax the commerce itself, rather than the local privilege.

The facts at bar correspond closely to those of the *New Jersey Bell Telephone* case. In actual operation, and under

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judicial sanction, the tax here being litigated is in addition to and not in substitution for a property tax. Moreover, it is measured by a quantity (gross receipts) which bears no reasonable relationship to the taxable subject—namely, the local franchise privilege—since the tax base indiscriminately includes receipts from both interstate and local carriage. We respectfully submit that the *New Jersey Bell Telephone Company* case requires reversal of the judgment of the Supreme Court of New Jersey.

Of course, in addition to showing the striking coincidence between the facts of the case at bar and the facts in *Galveston Railway* and *New Jersey Bell Telephone,* it is necessary to show an identity of principle as well. We submit that the relevant rule is this: A state may not levy any tax, apportioned or otherwise, upon gross receipts from interstate commerce. This is clearly true where the state lacks a taxable subject, and seeks baldly to tax the right to engage in interstate commerce within its borders. E.g., *Joseph* v. *Carter & Weekes Stevedoring Co.*, 330 U. S. 422 (1947); *Ozark Pipe Line Corp.* v. *Monier*, 266 U. S. 555 (1925). But it is also true where, as in the case at bar, a state seeks to tax gross receipts under circumstances which make those receipts an inappropriate or unreasonable measure of the value of a taxable subject. In such case, formal or linguistic considerations are disregarded. A tax has the same forbidden effect upon commerce whether it is stated by the legislature to be levied on the privilege of doing interstate business or whether it reaches the gross receipts under the guise of a reasonable tax upon a permitted subject. In short, appellant urges that the New Jersey Railroad Franchise Tax, as construed and applied, imposes a direct burden upon interstate commerce.

The decisions of this Court in *Western Livestock* v. *Bureau of Revenue*, 303 U. S. 250 (1938) and *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33 (1940) have led a number of commentators to believe that the "direct burden" doctrine has been sapped of its vitality. None-

theless, appellant submits that subsequent decisions of this court have re-affirmed that doctrine upon several occasions. In *Joseph* v. *Carter & Weekes Stevedoring Co., supra,* this Court specifically noted that *Western Live Stock* and *Berwind-White* had not impaired the authority of *Puget Sound Stevedoring Co.* v. *Tax Comm'n,* 302 U. S. 90 (1937). Yet *Puget Sound Stevedoring Company* was a case decided entirely upon the "direct burdens" rationale, a rationale which was further elaborated, and shown to be based upon practical considerations, in the *Carter & Weekes* opinion.

Again, in *Freeman* v. *Hewit,* 329 U. S. 249 (1946), this Court struck down a state gross receipts tax, in one particular application, on the ground that it imposed its burden upon the taxpayer for no other reason than that he had engaged in an interstate commercial transaction. Again in that case, the opinion of the Court pointed out that the "direct burdens" doctrine was evolved in order to meet the difficulties inherent in a federal system. The prohibition against direct tax burdens upon commerce was there viewed as but one application of the broader principle that the Commerce Clause, at least in the absence of Congressional permission, of its own force forbids certain types of state regulation upon interstate transactions. This principle is designed to leave Congress a free hand in the area of commerce, and to permit the development of a national system of trade—if need be without the aid of Congressional legislation—unhampered by the policies of the several states.

D.

The Question Presented by Appellant is not Foreclosed by any Decision of this Court.

Appellant has shown that two decisions of this Court require reversal of the judgment of the Supreme Court of New Jersey, and that the practical validity of the doctrine upon which those cases rest has been recognized by this Court in recent decisions.

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The only case which might be urged as justification for the dismissal of this appeal is *Central Greyhound Lines* v. *Mealey*, 334 U. S. 653 (1948). Some question as to the scope of that decision is raised by the dissent in *Interstate Oil Pipe Line Co.* v. *Stone*, 337 U. S. 662, 669 (1949). Particularly in footnote 18, p. 680, the dissenting Justices appear to have expressed the view that the *Greyhound* case authorizes the imposition of apportioned taxes upon gross receipts from interstate transportation.

Nonetheless, there are a number of reasons why this Court should not regard that case as controlling the one at bar. First, because the proposition apparently asserted in footnote 18 is inconsistent, not only with the direct adjudications of this Court, but with the general tenor and language of the *Interstate Pipe Line* dissent as well. Secondly, because the *Greyhound* case, as argued and decided, apparently did not involve the issues and contentions presented by the case at bar.

Examination of the summary of counsel's argument at pages 1635 and 1636 of 92 L. Ed. indicates that the attack upon the New York statute was made in terms different from those now urged by appellant. The principal concern of counsel for the appellant in the *Greyhound* case was over the question of apportionment, and he virtually conceded that a properly apportioned gross receipts tax would be constitutional in that particular case. It does not appear, moreover, that counsel for Greyhound ever contested the appropriateness of the measure to the subject taxed. It seems to have been assumed by Court and counsel alike that an apportioned tax would be "a constitutionally fair demand by the state for that aspect of the interstate commerce to which the state bears a special relation." (334 U. S. at 661).

In the instant case, however, contentions of appellant go beyond the narrow ambit of the *Greyhound* argument. It is here contended that an apportioned tax, which in effect

reaches gross receipts, is invalid under the circumstances here shown for the reason that it bears no fair relation to the value of any constitutionally taxable subject. The contention we make draws into question, in a way which the argument of counsel for Greyhound did not, the present status of the "direct burden" theory of constitutional limits on state taxation. Inasmuch as recent decisions of this Court, *e.g., Joseph* v. *Carter & Weekes S. Co., supra; Freeman* v. *Hewit, supra,* applying the "direct burden" concept have recognized the inherent soundness of its underlying policy, we respectfully submit that the instant case should receive a full hearing, and that this Court should consider whether or not, upon the facts here shown, the tax under attack is unconstitutional.

This Court recently said that in the field of state taxation under the Commerce Clause,

> ". . . opinions must be read in the setting of the particular cases and as the product of preoccupation with their special facts."

Freeman v. *Hewit,* 329 U. S. 249, 252 (1946).

In light of this rule of decision appellants respectfully submit that the *Central Greyhound* case does not control the case at bar. The decisive elements in the case at bar simply were not urged or considered in the *Greyhound* case.

POINT III

Conclusion

Appellant respectfully submits that it pointedly drew into question before the Supreme Court of New Jersey the validity of a state statute as construed and applied. The State Supreme Court decided in favor of that statute's validity as against a claimed Federal right. Further, the

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questions of Federal constitutional law urged are substantial. Precedents of this Court, and a principle of decision which has consistently been given effect by a majority of the justices of this Court, would seem to require that the judgment appealed from be reversed. We submit therefore that the jurisdictional requirements of Section 1257 (2) of the Judicial Code, 28 U. S. C., and of Supreme Court Rule 12 have been satisfied. Appellant therefore respectfully urges that the Appeal be retained.

JAMES D. CARPENTER,
Attorney for and of Counsel with Appellant,
75 Montgomery St.,
Jersey City 2, N. J.

DAVID I. MACKIE,
ELMER J. BENNETT,
MILTON A. DAUBER,
On the brief.